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Bloomberg Businessweek



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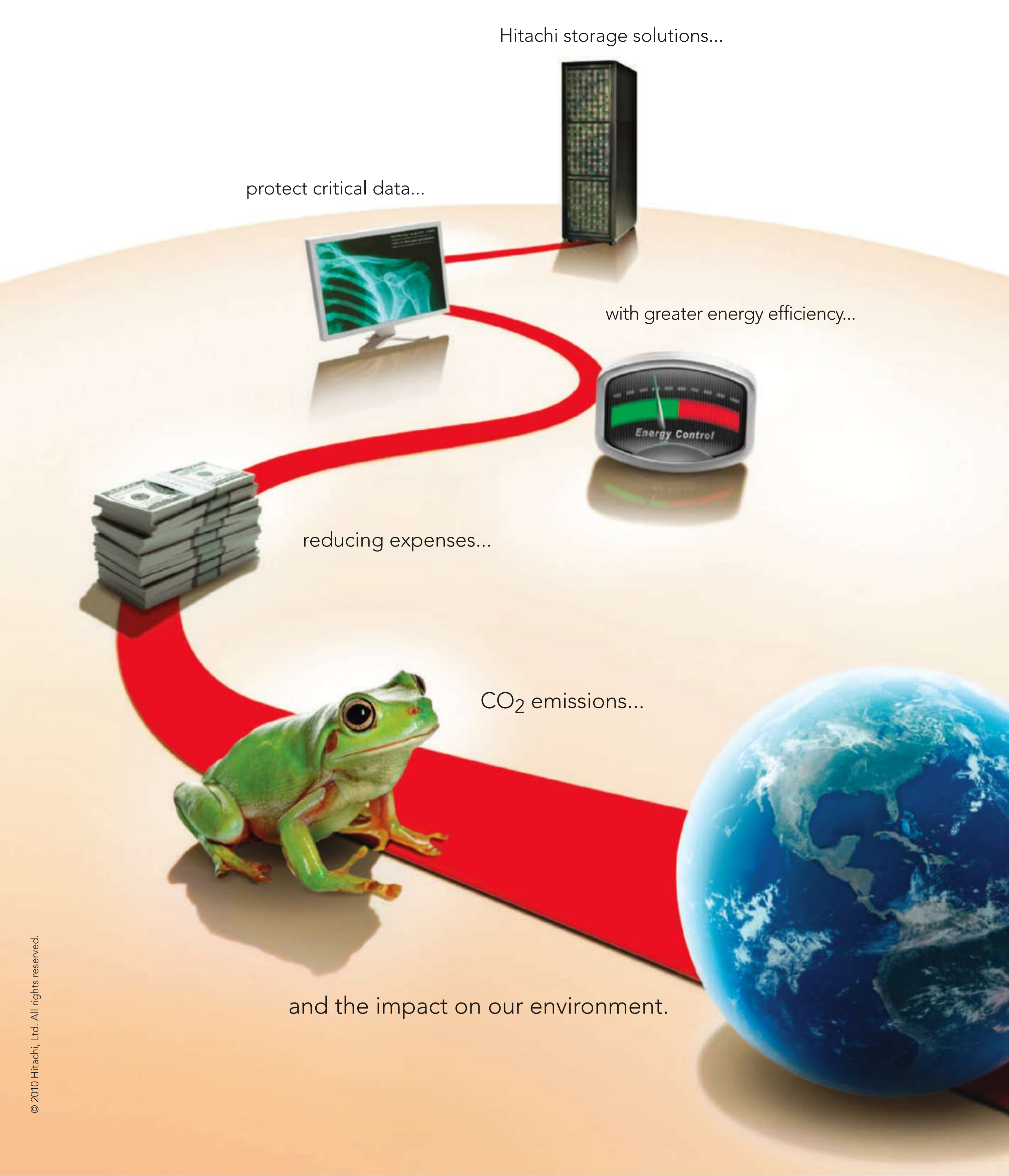
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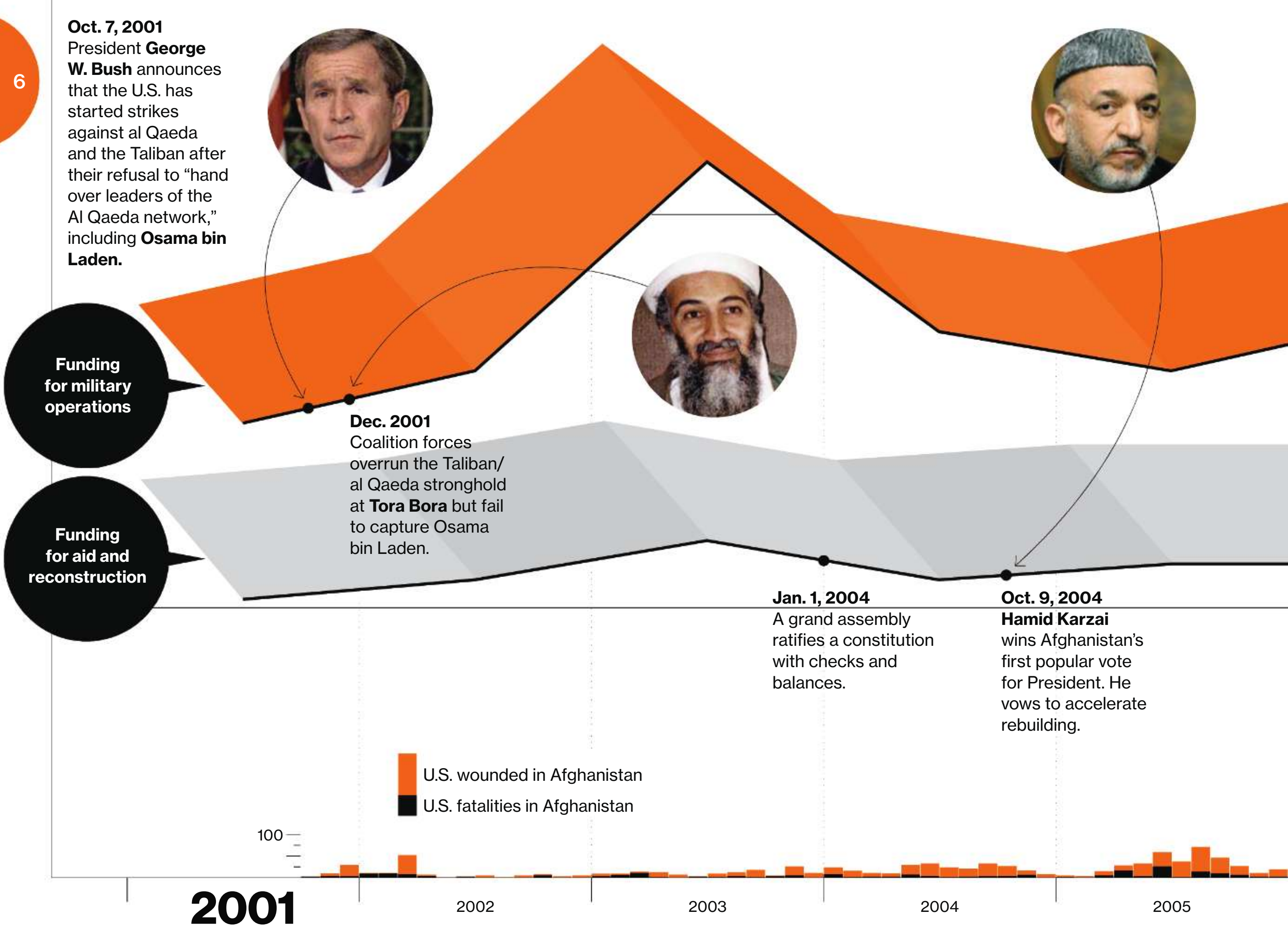
A Troubling Anniversary

The costs of the war in Afghanistan—tallied in dollars and lives—suggest a deepening quagmire. By Peter Coy, Evan Applegate, and Kenton Powell

Nine years have passed since the U.S., still reeling from the terrorist attacks of Sept. 11, went to war in Afghanistan. The conflict that began on Oct. 7, 2001, is not going according to plan. The main target of the American assault, Osama bin Laden, remains at large. The extremist Taliban, who sheltered bin Laden and his al Qaeda terrorists, were quickly ousted from Kabul, but soon regrouped and now dominate southern Afghanistan. *The Washington Post* reported on Oct. 6 that the Taliban were in secret talks with the government of Hamid Karzai to end the war. If the U.S. removed its troops now, the Taliban might well destroy Karzai's elected, albeit corrupt, government.

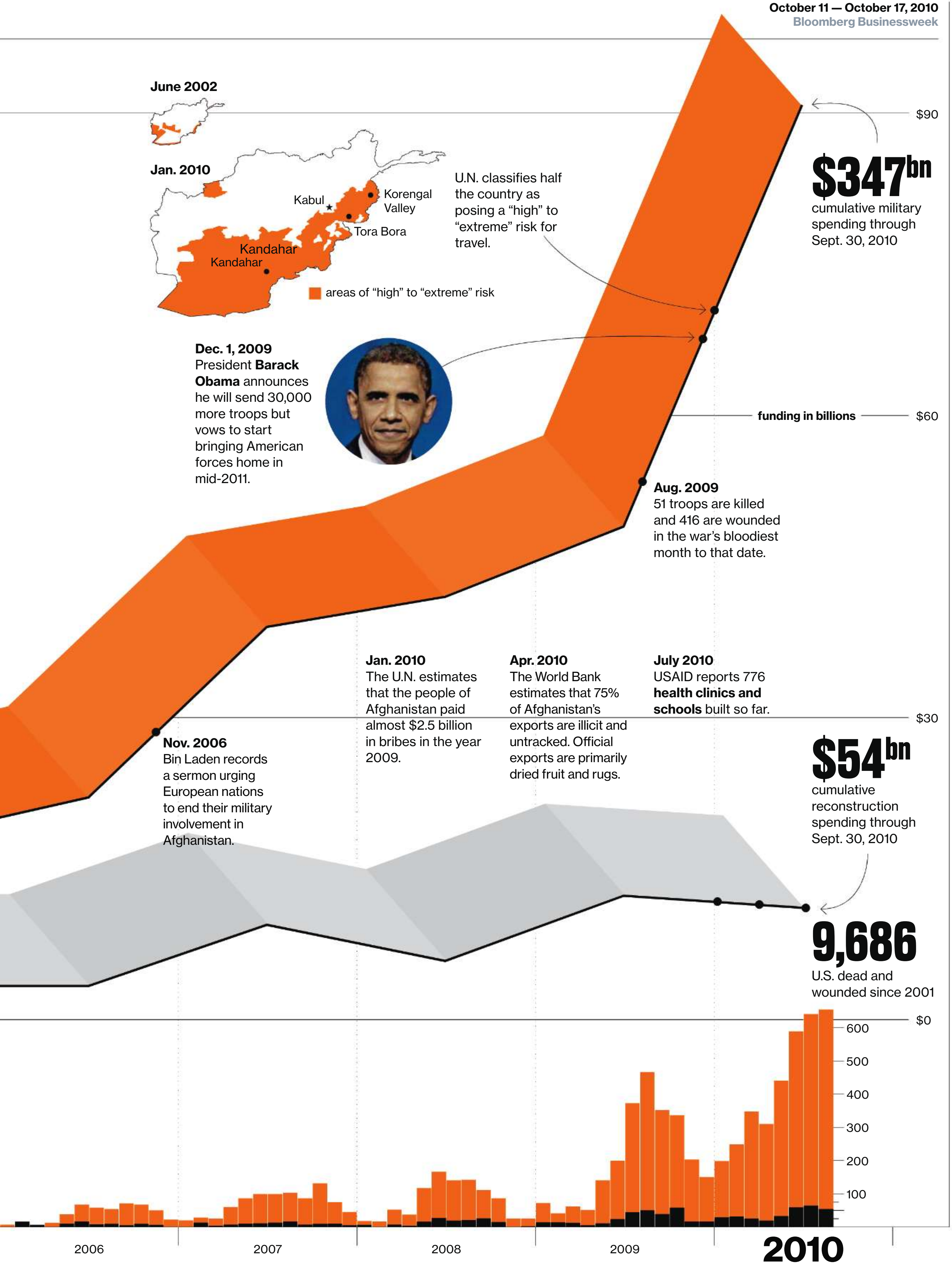
These graphics show what nine years of war has cost in American blood and treasure, and the return on investment to date. The orange ribbon represents the annual funding for military operations in Afghanistan, according to the nonpartisan Congressional Budget Office. It falls on the left as the U.S. turns its attention to Iraq, and shoots up on the right, reflecting the surge that President Barack Obama announced last December–a commitment of 30,000 more troops in the hopes of crushing the Taliban and allowing a drawdown beginning in July 2011. The gray ribbon, notably lower and flatter, represents CBO estimates of funding for aid and reconstruction. At the bottom of these pages is a time line of U.S. casualties. The monthly tolls were modest in the early years but have worsened. The summer of 2010 was the bloodiest to date. **B**

FROM LEFT: DOUG MILLS/AP PHOTO; AFP/GETTY IMAGES; EMMANUEL DUNAND/AFP/GETTY IMAGES; JULIE JACOBSON/AP PHOTO; DATA: CONGRESSIONAL BUDGET OFFICE, U.N., DEFENSE DEPT., WORLD BANK



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HANDS ACROSS THE Global Table

In-person meetings are key to forging successful **business relationships.**

The engine of global business travel might not be roaring yet, but it is beginning to hum again. The International Air Transport Association reported that during the first half of 2010, first- and business-class passenger demand on worldwide air routes rose by 11.9 percent year-over-year. During the same period, according to the American Express Business Travel Monitor, U.S.-based business travel jumped by 24 percent to London, 30 percent to Frankfurt and 24 percent to Tokyo.

Although many companies have cut travel budgets, that strategy can backfire. A 2009 study of 9,500 U.S. companies by HIS Global Insight, conducted for the National Business Travel Association, concluded that business travel spending produces an average return on investment of 15 to 1.

British Airways has been helping to prime the pump of intercontinental business travel with an ongoing program called **Face-to-Face** that it launched during the depths of the global recession in 2009. The airline invited representatives of small and medium size businesses to submit a short essay explaining why their companies would benefit from travel overseas, and awarded free flights and other valuable business support to one hundred hand-selected winners. The program will enter its third year in 2011.

Despite all the current attention given to videoconferencing and web-based meetings, the premise of the British Airways program is simply that nothing nurtures and sustains global business connections like personal, face-to-face sit-downs. That viewpoint was buttressed in a worldwide survey of 2,300 Harvard Business Review subscribers, commissioned by British Airways; 79 percent of those executives polled said that person-to-person meetings *"are the most effective way to meet new clients to sell business;"* and 89 percent agreed that face-to-face sit-downs *"are essential for 'sealing the deal.'"*



That was certainly true for Morgen Newman, a previous winner in the program. The young entrepreneur is co-founder (along with two college pals) of a start-up company called **IdeaPaint** (www.ideapaint.com), a coating of which can transform any office wall into a mammoth dry-erase whiteboard. His prize travels took him to Australia and India, where he signed up distributors who are giving his company a foothold in new foreign markets. Why not size them up on the computer screen instead of flying thousands of miles? He wanted to make sure he could trust them with his products. "Real trust comes after hours of eye contact, tours of facilities, and conference room negotiations where each side sweats onto the same table," Newman says, "and it all ends with a handshake over a cold beer." He said he would never give his business "to someone I have never met, never shaken hands with." Those new foreign distribution deals have boosted IdeaPaint's revenues to the point where the young firm can now afford a larger travel budget. "We expect to have multiple people traveling to various parts of the globe as we continue to scale up our presence," he said.

"Real trust comes after **hours of eye contact, tours of facilities, and conference room negotiations** where each side sweats onto the same table."



To find out how British Airways can help your business grow internationally, go to ba.com/facetoface

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I HAD A PRODUCT CLIENTS HAD TO SEE TO BELIEVE.

THANKS TO FACE-TO-FACE MEETINGS, THEY DID.

-Morgen Newman, IdeaPaint co-founder





Morgen Newman and his college friends had a great idea: dry erase paint. They just needed to get the right partners to sell it. Now, thanks to British Airways, IdeaPaint has distributors from India to Australia, and business couldn't be better.

Last year at British Airways, we put hundreds of small business owners in front of the people they needed to see – for free. This year we're doing it again.

To find out more visit ba.com/facetoface.

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Global Economics

Israel: An Economy Without a Diaspora

▶ The same families pop up in real estate, telecom, energy, and finance

▶ "We need to reduce the concentration of power"

Israel's economy is widely seen as a high-tech success story. Yet to many Israelis the real players in their economy are not programmers or venture capitalists. Rather, they are the 20 or so Israeli families who control banks, supermarkets, telecoms, real estate, gas stations, and utilities–businesses that underpin much of daily life.

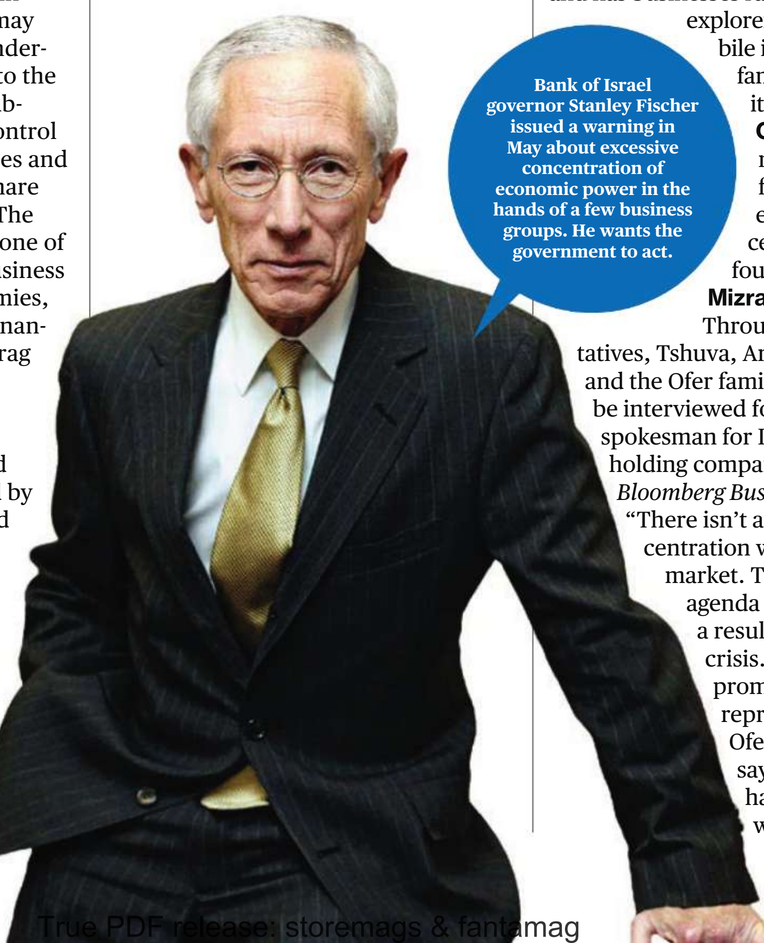
Too much, says Stanley Fischer, the governor of the Bank of Israel, who has sounded the alarm over the power concentrated in the hands of these families. Fischer, a world-renowned economist who mentored Ben Bernanke and who has run Israel's central bank for five years, says the influence these companies wield may undermine Israel's growth by undercutting competition. According to the central bank's annual report, published in May, the top families control 25 percent of the listed companies and 50 percent of the total market share in the Tel Aviv Stock Exchange. The bank warns that this represents one of the highest concentrations of business power among developed economies, posing a "systemic risk" to the financial system and threatening to drag other segments of the economy down should the tycoons falter.

The business elite developed when a few entrepreneurs ended up owning companies privatized by the government in the 1980s, and it has become a hot-button issue in Israeli politics. The government is warning that it will take action. Prime Minister Benjamin Netanyahu told *Bloomberg Businessweek*: "The Israeli economy has come a long way, but we have a long way still to go. We need to reduce the concentration of power in many key sectors of our economy and promote greater competition."

The same names crop up in many sectors of the economy. Nochi Dankner is probably the most prominent of the tycoons. Although he owns about 3 percent of **Credit Suisse** and prized foreign properties from Las Vegas to Manhattan, his real power comes from Israel. Dankner split off from an already influential clan that made its fortune in the salt industry: He now runs a web of companies through his **IDB Holdings.** All Israelis are touched by Dankner's businesses, whether they use mobile phones provided by **Cellcom**, the country's top cellular operator, shop at the No. 1 supermarket chain **Shufersal**, or invest in mutual funds offered by **Clal Finance**, Israel's largest financial institution outside the banks.

Shari Arison, who became a target of local talk show gibes for claiming to have prophetic powers, owns No. 2 lender **Bank Hapoalim** and real estate developer **Shikun & Binui**. Arison, whose brother Mickey owns the **Miami Heat** and operates **Carnival Cruise Lines** for the family, inherited the investments from her late father, Ted. She's Israel's richest woman. Isaac Tshuva's **Delek Group** holds two financial companies, **Phoenix Holdings** and **Excellence Nessuah**, and has businesses ranging from a gas explorer to an automobile importer. The Ofer family counts among its holdings **Israel Chemicals**, which makes fertilizer from Dead Sea minerals, and a 20 percent stake in Israel's fourth-largest bank, **Mizrahi-Tefahot**.

Through their representatives, Tshuva, Arison, Dankner, and the Ofer family declined to be interviewed for this article. A spokesman for IDB, Dankner's holding company, e-mailed *Bloomberg Businessweek* to say: "There isn't any problem of concentration within the Israeli market. This is a populist agenda which arose as a result of the financial crisis." Pinhas Rubin, a prominent lawyer who represents Arison, the Ofers, and Tshuva, says the families have not done wrong: "Big



Bank of Israel governor Stanley Fischer issued a warning in May about excessive concentration of economic power in the hands of a few business groups. He wants the government to act.

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Nochi Dankner

Net worth:
$1 Billion

While not the wealthiest tycoon, Dankner may be the most influential, thanks to his strength in retail (Shufersal) and telecom (Cellcom) and his use of various holding companies to extend his reach. He collaborates with Tshuva on U.S. real estate deals.



Isaac Tshuva

Net worth:
$3 Billion

Born in Libya to a poor Jewish family, Tshuva started in construction and branched out. His Delek Energy has discovered major gas fields off the coast. The Hadera water plant is the world's largest desalination effort. Tshuva owns a stake in Delek Auto.



Shari Arison

Net worth:
$4.5 Billion

Arison inherited her father's empire, which includes Carnival Cruise Lines. Arison Holdings' Bank Hapoalim, the No. 2 bank in the country, is a major force in Israeli finance. Residential real estate developments built by Shikun & Binui are all over Israel.

Oil Refineries Ltd.



This Ofer family operation runs Israel's biggest refinery.

Water Desalination



Tshuva's Hadera water plant will supply about 20 percent of Israel's drinking water. An Arison unit is a partner.

Zim Shipping



The Ofers' Zim Shipping operates globally.

Bank Hapoalim



The Arisons' Bank Hapoalim has more than 200 branches throughout Israel.

Haifa · Hadera · Tel Aviv · Rishon LeZion · Ramla · Jerusalem · Dead Sea · Eilat

The Ofer Family

Net worth:
$7.2 Billion

Two generations of Ofers, Sammy (below right) and Yuli and Sammy's sons Idan (left) and Eyal, control one of the world's biggest shipping lines. Their other holdings include Israel Chemicals—the second-biggest publicly traded company—and interests in an electric car company and Israel's No. 4 bank.

Shufersal

Dankner's grocery store chain is the largest in Israel.

Nesher Cement



Dankner's cement company dominates the industry.

Israel Chemicals



A main asset for the Ofers, this company extracts chemicals from the Dead Sea.

Salt Industries

Arison controls this major salt producer, which has an operation at the tip of the Negev.



DATA: *GLOBES* NEWSPAPER, COMPANY REPORTS, BLOOMBERG

groups in a small country don't necessarily translate into less competition. The Israeli media, as it often does, is twisting and exaggerating the reality."

Advocates of reform cite several examples of the tycoons' behavior as evidence they must be curbed. When Israeli importers wanted to buy cement from Turkey to compete with Nochi Dankner's **Nesher Israel Cement Enterprises**, then-Trade Minister Ehud Olmert levied duties of almost $6 a ton on the imports, claiming that otherwise the cement would be dumped at rock-bottom prices. That decision ensured that Nesher would keep its 90 percent control of the industry. The government says it reached an agreement with Turkey to drop the duty on those producers who agreed not to dump.

According to a July report from the Jerusalem Institute for Market Studies, a think tank, units of the Ofers' **Israel Corp.** get a major chunk of the government grants and tax breaks earmarked for manufacturers and exporters—which in turn makes Israel Corp., and by extension the Ofer family, even more powerful. The report recommends that the government abolish the grants, since its authors say the grants bestow unfair advantages on the largest holding groups. A spokesman for Israel Corp. says the company has acted in accordance with the law.

What also endangers the economy, say critics, is the families' control of many financial institutions. "Influential businessmen such as Nochi Dankner, through Clal Insurance, or Shari Arison, through Bank Hapoalim, can gain clout in other industries by the sheer influence they exercise with their large holdings in the relatively small financial industry," says Miki Rosenthal, a documentary maker whose film on the Ofer family's influence on the government was screened on television only after a legal battle with the family.

On the flip side, an oligarch's woes can turn into Israel's woes. Lev Leviev, a wealthy diamond merchant and developer, borrowed about $2 billion from financial institutions in Israel to acquire property from Russia to Manhattan, including the old New York Times building. Last year he dragged the entire Tel Aviv Stock Exchange down 2.3 percent when he told investors he couldn't pay off the debt on time. Investors

Global Economics

50%

Tycoons' share of the market value of the Tel Aviv Stock Exchange

feared a default by his **Africa Israel Investments** would damage every major institutional investor in Israel and eventually hurt the economy. Although Africa Israel restructured its debt and the market has recouped its losses, regulators are still concerned by the damage that one large group can inflict on the rest of the economy.

Now, as Israel gets back to work after its September holidays, pressure on the government to act is likely to pick up. The Finance Ministry is studying a proposal to bar groups that own financial companies from holding industrial businesses. "There is a danger to the economy and we need to make sure we counter-act," Avi Simhon, head of Finance Minister Yuval Steinitz's economic advisory board, said in an interview in Jerusalem. "I would guess we would reach some decisions in less than a year."

A draft law would expand the powers of the Israel Antitrust Authority to act against groups it classifies as oligopolies stifling competition. The bill, now making its way through the parliamentary approval process, would allow the authority to go beyond setting regulations for a particular market. It would be empowered, for example, to reduce or eliminate costs for consumers switching from one cell phone or cable service to another, or to act against cross-ownership of companies that have "a chilling effect" on competition, says Ronit Kan, commissioner of the IAA. Finance Minister Yuval Steinitz says the government will find a solution "gradually." He adds that the government does not want to make things worse by acting rashly.

One more thing about the tycoons disturbs Israelis. It's called *hon v'shilton*, literally translated as capital and government, an expression Israelis use to describe the rich's influence on government. The top families have been accused by government watchdogs of dishing out well-paid private sector jobs to government officials who eventually end up dealing with their ex-colleagues in the ministries. Nir Gilad, the former accountant general at the Finance Ministry, now works for the Ofer family as chief executive officer of **Israel Corp.** and as a board member of other Ofer-controlled companies. Arie Mientkavich, who in the 1990s served as chairman of the board of the Israel Securities Authority, the Israeli equivalent of the Securities and Exchange Commission, joined Dankner's company **Elron** as chairman in January 2007. Yoram Turbowicz, chief of staff to former Prime Minister Ehud Olmert, works for Isaac Tshuva as chairman of **Delek Energy Systems**. "These tycoons hold more power than the government," Shelly Yacimovich, a member of the Labor party known for her populist outbursts, said at a conference in Tel Aviv in July. "We urgently need to act."
—David Wainer and Calev Ben-David

***The bottom line** The Israeli government is worried about excessive concentration of economic power in the hands of a few families.*

Politics

A Reformist Leader Who Cannot Reform

▶ The fiasco of the Games exposes the Indian Prime Minister's flaws

▶ "The bigger things that are needed are things he hasn't even tried for"

Indian Prime Minister Manmohan Singh, 78 and silver-bearded, is known for his soft voice and polite manner. Two weeks ago, though, as India faced international humiliation over how unprepared it was to host the Commonwealth Games in New Delhi, he lost his temper, according to three people present at an emergency Cabinet meeting. "Just get it done," he snapped at the Minister for Sports when it became clear that repairs were urgently needed on stadiums and athletes' housing. An outright fiasco was avoided, though India has still sustained plenty of damage to its reputation.

Just as they did after the terrorist siege in Mumbai in 2008, Indians have seen the government's failure to handle the Games efficiently and effectively as a metaphor for how it handles the country. What Indians want to know is very simple: When confronted with a challenge, can their government get it right?

Under Singh, the answer often has been no. His second term as Prime Minister and head of a coalition built around the Congress Party, which runs until 2014, started with great expectations. In the 2009 election Congress

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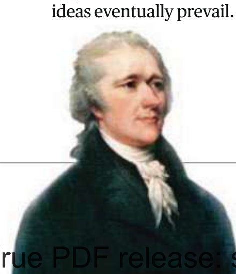
Trade

The United States Of Tariffs

Congress' call for punitive tariffs on Chinese goods goes against the free-trade ideology the U.S. has espoused for years. Yet the U.S. has used tariffs for more than two centuries to raise revenue and protect American industry.

1791

In his Report on Manufactures, Treasury Secretary Alexander Hamilton proposes that tariffs be imposed on foreign goods to foster manufacturers at home. Although political opposition is intense, his ideas eventually prevail.





1824-1828

The powerful Senator Daniel Webster of Massachusetts switches from opposing tariffs to supporting them as New England evolves into a manufacturing economy. Tariffs rise to over 50 percent on many imports.

1832

South Carolina, dependent on cotton exports and with no industry to protect, nullifies the Tariff of 1828 inside the state. Congress compromises.





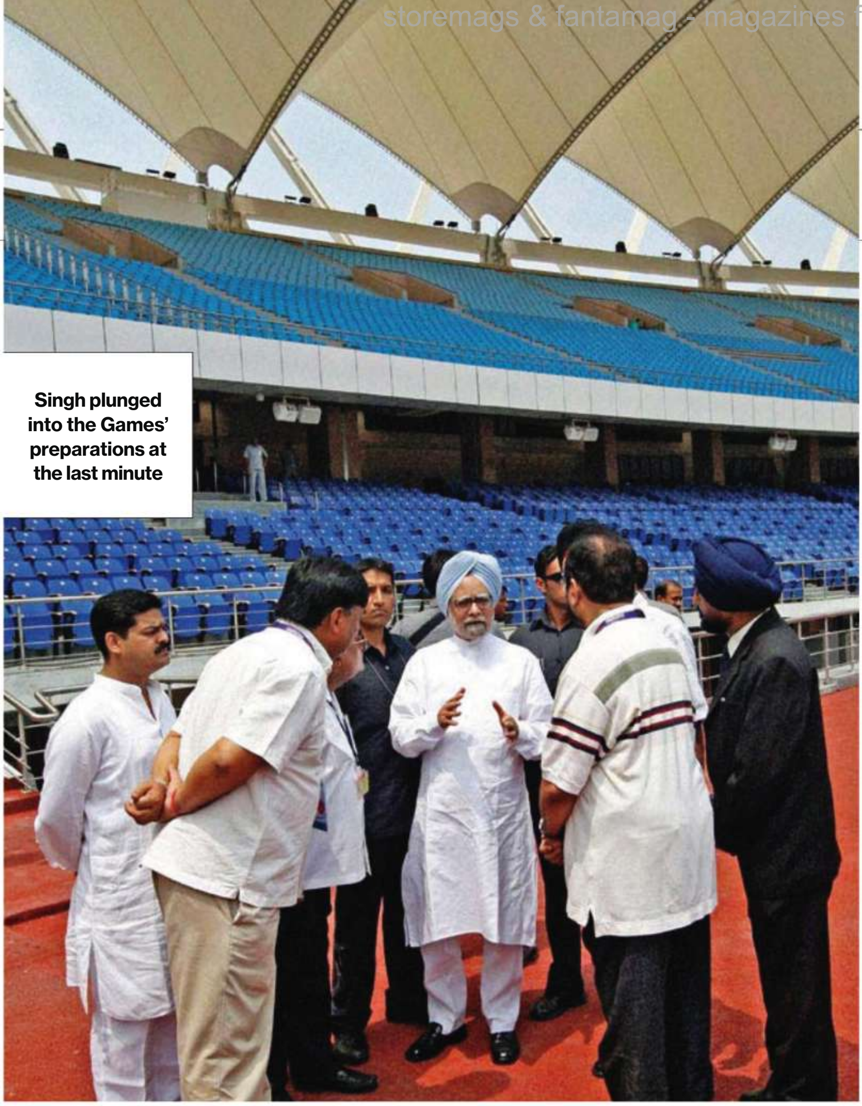
1861-1865

The cost of defeating the Confederacy drives the Republican-controlled Congress to push tariffs back up to 49 percent. After the war, tariffs stay high, despite the increasing efficiency of American factories.



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Singh plunged into the Games' preparations at the last minute

YORAY LIBERMAN/GETTY IMAGES; ASSAF SHILO/ISRAEL SUN; MOSHE SHAI/ISRAELIMAGES; COURTESY ZIM; NIR ELIAS/REUTERS. THIS PAGE, INDIA: AP PHOTO

had managed to assemble a strong enough majority in Parliament that it no longer needed its Communist allies, who had been an obstructive force during Singh's first term.

When the Congress Party was reelected, the Bombay Stock Exchange Sensex index shot up 17 percent in less than 60 seconds. Investors hoped that Singh, the economist who first opened India to the West in 1991, would deliver on big-ticket reforms. "There certainly was an expectation within the equity markets—and also economists—that would happen," says Robert Prior-Wandesforde, head of South-East Asia and India Economics at HSBC.

Instead, Singh's promises to reform rigid labor markets and ease the difficulties that manufacturers encounter in acquiring land have gone nowhere. Efforts to introduce banking reform have failed, as have halfhearted attempts to tamp down double-digit food inflation, leaving India's poor buffeted by global commodity markets.

A long-running guerrilla war in India's mineral-rich central states has gotten worse, claiming more lives in 2010 than at any other point in the 33-year struggle. More than 100 people have been killed in recent street protests in Kashmir. "What we've seen since the [2009] elections are minuscule reforms—dropping petroleum subsidies, higher education reform at the margin," says Razeen Sally, director of the Brussels-based European Center for International Political Economy. "The bigger things that are needed are things he hasn't even tried for." A spokesman for the Congress Party did not return calls.

Many critics wonder how such an able man could achieve so little. As Finance Minister in 1991, Singh cut import tariffs, allowed foreign companies such as **Ford Motor** to set up factories, and removed regulations requiring government authorizations for new plants. The result was a burst of growth that ended the acute fiscal crisis threatening India.

One reason Singh has not repeated this performance may be his tendency to bore in on details—a useful trait when you're fixing a single ministry, less so when you're running an entire country. Singh showed this side of himself when he jumped into the Games mess, personally inspecting sites and ordering investigations. "It should not be the Prime Minister's problem to see if the loos are clean or the ceilings of a stadium are solid," says Lord Meghnad Desai, a professor emeritus of



1865-1914

The rift widens between free-trade farm states and pro-tariff industrial states. GOP leader William McKinley (left) backs tariffs; Later, Teddy Roosevelt's breakaway Bull Moose Party attacks them.



1930

As Depression threatens, GOP Senator Reed Smoot and GOP Representative Willis Hawley push through a bill that raises tariffs on over 20,000 imported items to record highs. Canada and Europe hike their tariffs in response.



1947

Free-trade ideology triumphs as Western nations sign the General Agreement on Tariffs & Trade. Sponsored by the U.S., the idea is to liberalize trade and avoid new trade wars. The WTO replaces GATT in 1995.

1994

The North American Free Trade Agreement creates one of the world's biggest free-trade zones.





2001

China enters the WTO. Soon, U.S. manufacturers protest that China is manipulating its currency to cheapen the cost of its exports.

2010

President Barack Obama tries but fails to persuade Chinese President Hu Jintao to strengthen the yuan. Congress threatens to impose punitive tariffs.



Global Economics

the London School of Economics and a member of the British House of Lords who knows and admires Singh.

Structural issues are hobbling Singh, too. India's raucous politics have never been amenable to the kind of discipline China's one-party state is capable of displaying, especially in economic development. Finally, the dynamics of the Congress Party may have affected the Prime Minister's performance. Rahul Gandhi, the 40-year-old son of the assassinated Prime Minister Rajiv Gandhi, is being groomed by his mother, Sonia, to take over as Prime Minister in a Congress government someday soon. (Rahul is grandson of Indira Gandhi, who was also Prime Minister, and also assassinated.) Both mother and son have shown a tendency for well-meaning yet expensive social programs, including food subsidies, rural work programs, and farm loan waivers. "The most significant change has come about in the social sphere, and one wonders how much that has to do with Singh," says Prior-Wandesforde, the HSBC economist. "The 2009 election was a vote in favor of social reform rather than a vote for massive economic reform."

53.2

The September reading of the Institute for Supply Management's index of nonmanufacturing businesses. A reading greater than 50 signals growth.

DATA: ISM



Checking methane levels at Arrow's coal-bed gas plant in Australia

If Singh can ride out the political storm triggered by the Games, and if Rahul's charisma helps the Congress Party win crucial state elections, the Prime Minister would still have three years to show real progress. He has maneuvering room: Economic growth has not yet stalled, though that's likely if the hardest reforms are not completed. Ruchir Sharma, head of emerging markets for Morgan Stanley Investment Management, warned in a report on Sept. 30 that India's 8.5 percent average growth rates in the past five years are in no way guaranteed to continue. Unless Singh's government focuses on ending crony capitalism, widespread corruption, and the insurrection, Sharma wrote, the country could go the way of the East Asian tigers of the 1990s, which couldn't sustain high growth over the long haul.

For now, India is holding its breath as the Games go on, hoping to avoid disaster. "It's just such a shame," says Radha Deshmukh, who turned 18 the same day the Prime Minister turned 78. "I wanted to sing the national anthem when our boxers won a gold medal." Deshmukh will instead watch the Games on television in Dubai. Her family, like many Delhites, decided to flee India until the athletes leave. —*Mehul Srivastava*

The bottom line *The problems besetting the Commonwealth Games reflect the larger problems dogging Prime Minister Singh's government.*

Oil and Gas

China's Energy Hunt Goes Unconventional

▶ A deal in Australia yields valuable expertise in coal-bed gas

▶ China's "technology is relatively backward"

Australia's Curtis Island, 300 miles northwest of Brisbane, is known for the countless birds that make their home in the island's mangrove swamps and gum-tree forests. For the Chinese government, Curtis Island is on the map for another reason: It is the proposed home for a new plant to liquefy natural gas taken from coal mines in the area. The developer of the plant, Brisbane-based **Arrow Energy**, is now co-owned by **PetroChina**, the state-owned energy company, which joined with **Royal Dutch Shell** to complete a $3.2 billion takeover of Arrow in August.

Until recently the Chinese have mostly tried to buy up conventional deposits of oil and gas around the world. Arrow Energy focuses on so-called unconventional reserves–in this case coal-bed methane, a coal by-product that is frequently difficult to mine. On Curtis Island, Arrow is hoping to take the coal-bed gas it has mined from the nearby mainland and cool it to about -260F,

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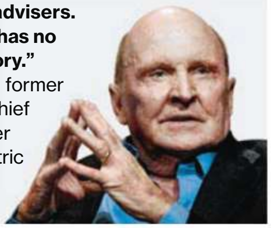
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American Airlines: Not much lift page 19 ▶

Quoted

"I don't think any Administration comes in trying to kill business. It's a bad idea. They're not going to last long with that. The President hasn't been served very well by his economic advisers. The President has no economic history."
—Jack Welch, former chairman and chief executive officer of General Electric



which will liquefy the gas and make it easier to transport by ship to China.

As PetroChina Chairman Jiang Jiemin said when the acquisition was announced, the Chinese giant is counting on Arrow to provide some of the expertise needed to develop such unconventional gas reserves back in China. The nation has only 2.46 trillion cubic meters of conventional natural gas reserves (conventional gas reserves are found between rock formations). China, however, may have more than 10 times that amount in unconventional gas deposits: China National Petroleum, China's largest energy supplier, puts the number as high as 30 trillion cubic meters. That 30 trillion also includes gas trapped in shale, which can be flushed to the surface through injection of water at high pressures.

Natural gas releases 44 percent less carbon dioxide than coal, China's top source of energy today, so switching to gas could help clear the country's smog-filled skies. Beijing policymakers want China to triple the amount of gas the country consumes to a targeted 10 percent of energy needs by the end of the decade.

30
TRILLION

Possible reserves in cubic meters of unconventional gas in China

To help reach that goal, China has to tap all that unconventional gas. Although the government has established ambitious production targets for unconventional gas inside China, the industry's performance has been underwhelming. China's "technology is relatively backward when it comes to developing unconventional resources," says Wang Aochao, head of China energy research at UOB-Kay Hian in Shanghai. The Chinese lag behind Western industry in drilling and extraction techniques for coal-bed and shale gas.

That's where foreign companies come in. Last year, Royal Dutch Shell signed an agreement with PetroChina to explore for unconventional gas in southwestern China. If projects there show promise, the Anglo-Dutch energy giant may invest $1 billion annually over the next five to seven years, says Shell Chief Financial Officer Simon Henry. In May the Chinese government announced a 25 percent increase in the price of domestically produced gas. The jump reflects the higher cost of producing hard-to-extract unconventional gas and creates more incentives for companies to expand exploration efforts. —*Bruce Einhorn and John Duce*

The bottom line *China's conventional reserves of natural gas are small. Its unconventional reserves may be more than 10 times greater.*

Currencies

Sticker Shock in Zurich As the Franc Rises

▶ **Even well-heeled tourists are reeling: McDonald's for $13.50**

▶ **The franc is "hurting us enormously. It's cutting our air off"**

The Swiss franc's 11 percent appreciation against the euro this year is forcing Urs Boehler, who runs Zurich's Les Millionaires jewelry store, to sell cheaper wares.

Boehler's shop is on Bahnhofstrasse, the city's ritziest shopping street. Even for his customers, prices have risen almost out of reach as international investors seeking safety pile into Swiss francs. Boehler's fanciest jewelry retails for around 150,000 Swiss francs. Three years ago, before the global financial crisis, these would have cost an American shopper $127,000. Today, with the Swiss franc at record strength against the greenback, that's more like $156,000. For the upcoming holidays, Boehler plans to sell watches for as little ➜

Tom Keene's EconoChat

Tom talks with Berkeley economist **Barry Eichengreen** about the fiscal mess and raising taxes

What have you learned from emerging markets that we can use to get our fiscal house in order?
I think we need to look not only to emerging markets but to other advanced economies. The fact of the matter is that we raise less in the form of public sector revenues than almost anyone, even when you add the states and municipalities to the federal government. So I am all for cutting waste and fraud, but I think we need and we will need in the U.S. what we euphemistically refer to as revenue enhancement.

That sounds like somebody from Berkeley. What, pray tell, is revenue enhancement?
We have to raise more taxes.

O.K., do we eliminate the Bush tax cuts? Do we try to get a value-added tax through?
Well, I think it is time to think about systematically remaking the tax system. There are many things we've inherited–including, for example, the deduction for mortgage interest payments–that if we were starting over we probably would not want to have.

If the U.S. decided to pursue fiscal austerity now, would there be a drag on the economy?
Now is not the time to cut public spending. Now is the time to develop a plan to balance the budget when the economy is growing robustly. I do not see a plan, and that is what worries me about the prospects for the dollar and, more broadly, the U.S. economy. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

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Global Economics



While more upscale brands draw window shoppers, Swatches sell

as 3,000 francs, a mere $3,100. "We wouldn't have taken this decision if we hadn't had to," Boehler says. The franc is "hurting us enormously. It's cutting our air off."

Switzerland is struggling to attract more visitors. It lost about 2 percent of its usual hotel visitors from Germany during the first half of the summer, according to the BAK Basel Economics research institute. American tourists are clutching their wallets. "We were warned that everything is very expensive," says Rudi Vaff, a 65-year-old visitor from Phoenix. "Food and hotel prices are out of this world." Swiss inflation is not a problem: The average cost of a room at a four-star hotel in Zurich rose just 0.4 percent in June, to 290.23 francs, from a year earlier, according to the Zurich Hotels Assn. Converted to euros, however, that's up about 16 percent.

Cheap meals aren't so cheap. "I spent 13 francs [about $13.50] on a **McDonald's** meal and I didn't even get a refill," says Julio Cesar Ponce, a 30-year-old computer science researcher from Aguascalientes, Mexico. In the U.S., the meal would have cost about half that, he says.

Linda Hofer heads **Swatch Group**'s namesake store at one end of Bahnhofstrasse. Farther up the street stores sell gilt-edged brands such as **Patek Philippe**, **Audemars Piguet**, and **Rolex**. "People come first thing in the morning," she says. "Then they walk up the street and all they see are higher prices before they finally come back to us." Swatch, based in Biel/Bienne, Switzerland, makes everything from budget plastic watches to pricey **Omega** and **Breguet** timepieces. It reported in August that first-half profit rose 55 percent, to 462 million francs, as revenue hit a record.

Vaff and Rita Rossi, his companion, planned to limit their purchases on Bahnhofstrasse as they window-shopped at **Chanel** and **Prada** and **Hermès**. Says Rossi, 56: "You take a closer look and say, wait, I can get that cheaper at home." Ⓑ

—*Antonio Ligi and Klaus Wille*

The bottom line *Investors have found safety in the Swiss franc. As the franc has climbed higher, Swiss retailers and hoteliers have suffered.*

Seven Days

Events of note in the week ahead

by Ira Boudway and Caroline Winter

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Columbus Day

French industrial production for August



▶ **Wisconsin Senate race:** Democrat Russ Feingold and Republican challenger Ron Johnson will meet for the second of their three debates. Recent polls have shown Johnson in the lead.

12

Federal Open Market Committee minutes from Sept. 21 meeting

Japan's consumer confidence for September



▶ **Intel earnings report:** Intel cut forecasts due to weakened demand in August.

▶ **CSX earnings report:** Fourth-quarter growth is expected. Railroads are benefiting as shipping recovers.



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Delaware Senate candidates Christine O'Donnell and Chris Coons in a TV debate

Earnings reports from JPMorgan Chase and Apollo Group

▶ **China trade balance:** A survey of economists forecasts a $17.75 billion surplus for September.

▶ **U.K. September jobless claims:** Claims in August rose for the first time in seven months.

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Frieze Art Fair opening in Regent's Park, London

China's Leading Economic Index



▶ **Google earnings report:** Wall Street boosted estimates amid rising optimism about online ad spending.

▶ **Friends of Europe:** European Council President Van Rompuy will attend the annual State of Europe roundtable.

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Ben Bernanke at Boston Fed Conference

Earnings reports from GE, Mattel, and Tempur-Pedic



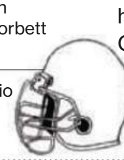
▶ **Charles Schwab earnings report:** Analysts expect profits will be muted due to a decline in trading revenue.

▶ **Spain's Leading Economic Index:** In July, the Spanish index increased for the first time since December 2009.

16

Pennsylvania gubernatorial debate between Dan Onorato and Tom Corbett in Pittsburgh

College football: Ohio State vs. Wisconsin



▶ **Victory 2010 fundraiser:** Sarah Palin headlines the Republican National Committee's event in Anaheim, Calif.

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Liverpool vs. Everton in the 214th Merseyside Derby

▶ **Obama in Ohio:** The President holds the third of four midterm rallies for Democrats.



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8:05 pm Pay a supplier in Dubai.
8:10 pm Business dinner downtown.

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Contents ▶ India's bitter choice: Water for steel or food? 20 ▶ The expensive face-lift on Burger King's menu 21 ▶ Wal-Mart teams up with suppliers to boost its purchasing clout 23 ▶ Traditional truck buyers are steering clear of Toyota 24 ▶ Briefs 25 ● Edited by James E. Ellis

Why American Airlines Remains Stuck at the Gate

▶ **Once the nation's largest carrier, American has been hurt by labor woes and high costs**

▶ **"They're playing the hand they were dealt by avoiding bankruptcy"**

For much of the past decade, U.S. airlines have scrambled to remake themselves. **United Airlines**, **Delta Air Lines**, **US Airways Group**, and Northwest Airlines all made trips through bankruptcy court and emerged with trimmer operating and labor costs. Then many carriers went into acquisition mode. Delta snapped up Northwest in 2008, United this month completed its takeover of Continental Airlines, and on Sept. 27 **Southwest Airlines** said it will buy **AirTran**.

Through it all, **AMR**'s American Airlines looked healthy enough to go it alone. Once the global leader, the Fort Worth-based carrier managed to avoid bankruptcy. Now, as other airlines recover, American is paying the price for sidestepping the near-death experiences of its competitors. It's bleeding red ink. Its stock price has dropped 20 percent this year, the only decline among the six biggest U.S. carriers. And its pretax margin in the first half was -4.3 percent, the only negative among its peers. "They're playing the hand they were dealt by avoiding bankruptcy," says Stifel Nicolaus analyst Hunter Keay. "It's unfortunately costing them dearly."

Labor costs remain the big challenge. Of the almost 50,000 workers represented by unions at American, only a group of 90 technical specialists has approved a new contract. The carrier has been negotiating with its pilots for more than four years, while its flight attendants, airport ground workers, and mechanics have been in contract talks for more than two.

A continuing obstacle to labor agreements is the $1.6 billion in annual concessions the unions agreed to in 2003 to help keep the carrier from seeking bankruptcy protection. Filing for Chapter 11 protection would have allowed American to alter its labor accords unilaterally. Workers want



American has been in contract talks with its pilots for more than four years

BRIAN SNYDER/REUTERS

Political roadblocks for high-speed rail page 28 ▶



the airline to restore at least some of the concessions. Management says that on labor costs alone, the carrier is still at a $600 million-a-year disadvantage to rivals. "It's a big brick in our backpack to being competitive in this industry," says Senior Vice-President Jeff Brundage.

The Transport Workers Union scrubbed a tentative accord for 10,600 baggage handlers and ramp workers in June. Mechanics and stock clerks rejected a three-year contract in August and authorized TWU leaders to call a walkout among their 12,700 members.

It's much the same with flight crews. About 9,600 American pilots are working at 1993 hourly rates, leaving them with "massive anger and frustration" over a lack of progress in the talks, says David Bates, president of the Allied Pilots Assn. Adds Laura Glading, president of the Association of Professional Flight Attendants, which has 16,550 active-duty members at the carrier: "You can't come to labor and keep taking and taking and taking." Glading will meet with a federal mediator on Oct. 19 to press a union request that bargaining be declared at a stalemate, which could trigger a countdown toward a strike, the first at a big U.S. airline since 2005.

American has said liberalizing work rules would allow it to increase wages while keeping its current cost structure. Studies show the airline is at or near the bottom of the industry in productivity, says Jerry Glass, president of F&H Solutions Group and a former US Airways labor executive. Says Stifel Nicolaus' Keay: "It's critically important that the labor groups understand that work rules are what is preventing American from reporting profits in 2010 to a large degree."

American faces operational challenges as well. To counter a possible loss of corporate accounts to rivals who are adding routes through mergers, Chief Executive Officer Gerard Arpey is trying to expand pricing alliances with carriers outside the U.S. Those partnerships allow airlines to share revenue, marketing expenses, and frequent-flier programs. Adding more foreign partners lets American capture a bigger share of high-fare international business travelers.

Arpey also is adding flights at hubs in five domestic markets used heavily by business travelers: New York, Los Angeles, Chicago, Dallas-Fort Worth, and Miami. By early 2011, 98 percent of American's available seats will touch those hubs, up from 88 percent a few years ago. American expects by the end of 2012 to have $500 million in annual revenue and savings from its international partnerships and the intensified focus on servicing business travel hubs. Still, counting fuel, labor, and other expenses, American's cost to fly each seat a mile in 2010's first half was 12.76¢, the most among the six biggest U.S. carriers, based on data compiled by Bloomberg.

Part of the financial drag comes from American's Boeing MD-80 jets, which make up the largest part of its 619-plane fleet. While they're slowly being replaced by Boeing 737s that are about 35 percent more fuel-efficient for each seat flown a mile, the MD-80s still account for about 40 percent of American's big jets and won't all be retired until about 2016 at the current replacement rate.

Those changes are unlikely to make up for the high labor costs. "The changes they are making in their flying are going to help," says James M. Higgins, an analyst at Soleil Securities. "For me, they're all completely dwarfed by labor and the question about what's going to happen there." —*Mary Schlangenstein*

The bottom line *American Airlines, once the nation's largest carrier, has fallen behind competitors because of high costs locked in by not seeking bankruptcy.*

100

COMPANIES

The number of publicly traded biotechnology companies in the U.S. that were acquired or ceased business since the end of 2007. That's a 25 percent drop.

DATA: BIOTECHNOLOGY INDUSTRY ORGANIZATION



Kandi is among the farmers in Orissa who fear losing water to steelmakers

Steel

India's Bitter Choice: Water for Steel or Food?

▶ **$80 billion in steel projects are stalled as farmers won't cede land**

▶ **India's poor worry "there won't be enough water for agriculture"**

Global steel giants **ArcelorMittal** and **Posco** are leading $80 billion in planned spending in India, an investment that would vault the country ahead of Japan as the second-biggest steelmaker. There's one hurdle: India's farmers and their water supply. The farmers refuse to move from irrigated land in three states that hold more than half of India's reserves of iron ore, a key material used in the making of steel. That's stymied Prime Minister Manmohan Singh's ambitions to more than triple India's steel capacity, to 232 million metric tons.

"We're not going to allow the government to take the land and water and give them to Posco," says Prasanth Paikare, a spokesman for opposition group Posco Prathirodh Sangram Samiti, which says it represents 25,000 farmers. "The government has promised us land at a new location, but there is no good land available in the state now and there won't be enough water for agriculture," he said in Bhubaneswar, the capital of Orissa state.

The farmers' concern over water for crops has delayed plans by ArcelorMittal, based in Luxembourg and London, South Korea's Posco, and at least five other rivals

FROM LEFT: HIGH SPEED RAIL AUTHORITY/ZUMA PRESS; PRASHANTH VISHWANATHAN/BLOOMBERG

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to benefit from a local steel market that has expanded by more than 55 percent since 2005 even as Indian imports of the metal tripled over the same period. Posco's plan to build a $12 billion plant in Orissa, for one, has been stalled for five years by farmers who refuse to move despite efforts to relocate them.

"With over 60 percent of India's population dependent on the monsoons for livelihood, there's population concentration and serious competition in areas with water," explains Rahul Jain, an analyst at RBS Equities India in Mumbai.

The continuing delays over water access are starting to worry Posco investors, says Im Jeong Jae, who helps manage $26.3 billion of assets at Shinhan BNP Paribas Asset Management. "India is very important because it has the best growth potential after China for steel demand and Posco can also source iron ore and raw materials there." The latest hurdle is an Environment Ministry report due this month on the impact of the Posco project. Tired of waiting, Chief Executive Officer Chung Joon Yang has announced competing investment plans in Indonesia and Vietnam.

The 160 million tons of planned steel capacity would consume 640 billion gallons of water a year, based on the average consumption by U.S. steel mills. That's enough to provide adequate water for drinking and cooking for 133 million people in India over the same period, according to government figures.

That level of water consumption would yield 1 million tons of rice a year, enough to feed 9 million people in India, based on U.N. Food and Agriculture Organization estimates. At today's price of $299 a ton, however, that rice would fetch only 0.3 percent of the value of the steel produced with that amount of water. "Posco wants our land, it wants our water," said Makar Kandi, 75, who supports a family of eight with a one-acre plot on which he grows betel leaves in Orissa's Dhinkia village. "Agriculture is our only means. We'll have no livelihood."

ArcelorMittal, the world's largest steelmaker, is also facing delays for a $10 billion mill in Orissa and another project in Jharkhand state. (Projects by **Tata Steel**, India's biggest maker of the metal, are faring no better in those two states and in Chhattisgarh.) According to an agreement with Jharkhand, ArcelorMittal would have access to 20 million tons of iron ore annually for 30 years. That's enough to raise the company's self-sufficiency in the commodity by 33 percent. "Securing iron ore assets has become very important for the steel companies as prices have been very volatile," says Elora Sahoo, an analyst at Dhanlaxmi Bank in Mumbai. ArcelorMittal is now trying to secure land at a different location in Jharkhand, says spokeswoman Mandakini Sud. There has been "good" progress in persuading locals, mostly people engaged in nonagricultural activities, to give up land, she says.

Posco is having a harder time because of declining rainfall in the Jagatsinghpur district, where it's planning its mill. Rainfall during the June-September monsoon period, critical for agriculture, declined by 26 percent from 2007 to 2009, forcing farmers to compete with manufacturers for water from the Mahanadi River. Posco plans to get water through pipes from the river's Jobra dam. "Opposition to the project is unfounded," Posco India General Manager Simanta Mohanty says. "We will not use local water. There's enough water available."

Undeterred, big steelmakers in June began exploring sites in the southern state of Karnataka, home to India's second-biggest iron ore deposit. The catch? Lack of water. —*Abhishek Shanker*

The bottom line *Competition is raging between steelmakers and farmers in India over access to water, which is critical to both groups.*

Fast Food

An Expensive Face-Lift On Burger King's Menu

▶ The No. 2 fast-food chain may need to spend billions on refurbishing

▶ "Customers were like, 'Wow, this is nice. Are we in the right place?'"

When Joyce Jacaruso Castillo grabbed a quick coffee at a **McDonald's** in Manhattan last month, she was wowed by the low lighting, cushioned stools, and piped-in bossa nova music at one of the chain's newly remodeled units. The 69-year-old New Yorker doesn't feel the same vibe at rival Burger King, however. "McDonald's is more uplifting," she says. "Burger King is so blah."

Leveling that playing field could be expensive for the new private equity owners of **Burger King Holdings,** who agreed in September to buy the chain for $3.3 billion. Burger King Chief Executive Officer John W. Chidsey said last month that 85 percent of the chain's 7,200-plus locations in the U.S. need to be remodeled. Modernizing stores with the company's new "20/20" redesign will cost about $500,000 each, he said in June, with some going as high as $1.1 million. That could push the cost past $3 billion. "The image is 20 years old," says Charles M. Fallon, president of Burger King's North American business. "We're working hard on making the economics work."

Persuading franchisees to go along may not be easy. Slowing sales at the No. 2 burger chain have made many store owners reluctant to spend on reno-



Burger King's new stores feature chrome, brick, and LCD screens

vations, says Steve Lewis, who owns 36 outlets near Philadelphia. So acquirer **3G Capital Management** may need to chip in funds to spur remodeling, says Jordan Krolick, president of consultant Tound & Drowth. "It's the hidden cost in any restaurant acquisition, and should be planned for as an addition to the initial investment," says Krolick, who previously ran acquisitions at McDonald's.

Susan Robison, a Burger King spokeswoman, says outlets without drive-throughs will be cheaper to remodel and franchisees can remodel using the old look, which costs less. Steven Lipin, an outside spokesman for 3G Capital, says "it's premature to talk about whether 3G's going to provide funding or what the cost will be" for upgrades.

McDonald's, which owns much of the real estate underlying its franchises, fuels renovations by matching 40 percent of funds put up by its franchisees, on average. At Burger King, franchisees, who own about 90 percent of outlets, are responsible for renovation costs and must remodel their stores every 10 years to Burger King's specifications.

Burger King unveiled its 20/20 redesign two years ago. So far, more than 30 U.S. restaurants have been outfitted with chrome-trimmed booths, brick walls, LCD menu screens, red and black paint, and "flame" chandeliers. Some franchisees say they won't pay for the extensive remodels. Lewis says four of his restaurants have come up for contract renewals in the past two years and he has opted for less expensive updates such as adding carpeting and terminals with Internet access. "I'm doing whatever the minimum is," he says.

Remodeling stores lifts sales 12 percent, according to Burger King. Shoukat Dhanani, who operates 61 Burger Kings in the Houston area, built the first 20/20 restaurant in the U.S. in May 2009. Sales are 40 percent higher than at his other locations, he says. Some customers couldn't believe the sleek store was a Burger King, he says. "Customers were like, 'Wow, this is nice!'" he says. "'Are we in the right place?'" *—Burt Helm*

The bottom line *Burger King's new owners could face a hefty bill to help update its restaurants, which trail competitors in performance and appearance.*

OPPOSITE PAGE: FOODPIX/GETTY IMAGES

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Retailing

To Boost Buying Power, Wal-Mart Woos Partners

▶ The retailer wants to combine its purchases with those of suppliers

▶ "When you put the volume together ... you can reduce the cost"

Wal-Mart Stores purchasing chief Hernan Muntaner has a dream: teaming the giant retailer with soda and snack maker **PepsiCo** to buy potatoes jointly for a lower price than either company can get on its own. That would allow both to earn more money on the chips and spuds they sell in Wal-Mart's supermarkets. So far, Pepsi isn't playing along. But with sales slowing in the U.S. and the price of sugar, meat, and wheat on the rise, the world's largest retailer is jointly purchasing a growing share of raw ingredients with manufacturers of food and household products sold in its stores. Products already being purchased with suppliers include sugar, which goes into the company's store-brand soda and five-pound bags, and paper, used in Wal-Mart's back-office printers. Muntaner envisions a day when his company will do it with most goods it sells.

"Around the world, we found we were buying the same raw materials" that Wal-Mart suppliers buy, says Muntaner, whose official title is vice-president for international purchase leverage. "When you put the volume together of what we bought and what [suppliers] bought, and buy from just one supplier, you can reduce the cost."

It's all about the retailing giant doing what it's become famous for: squeezing costs out of its supply chain. And although Wal-Mart is already feared by many suppliers for its enormous buying clout, it's convinced it can cut even better deals by consolidating its purchasing with partners. Currently, only makers of private label goods sold under Wal-Mart's house brands have joined in its so-called collaborative sourcing program. Manufacturers of branded products have taken a pass because they're loath to share pricing data and product formulas, say executives at three companies approached by Wal-Mart. Pepsi declined to comment.



Teaming with Pepsi to buy potatoes would reduce costs for both companies

Muntaner says that "in most cases" the branded companies "are more sophisticated than we are" in buying raw materials. "But we have found times when that wasn't the case," he adds. He declines to give specifics. "Sometimes it's very hard with a big company to have conversations like this," Muntaner says. "That is the main reason why we don't have Pepsi yet."



Muntaner's primary job is to circle the globe helping Wal-Mart's international divisions, from China to Japan to Brazil, find ways to use the company's massive buying muscle to lower what it spends on everything from copier paper to store-branded bottled water. Increasingly, that means selling the benefits of sourcing collaboratively. Muntaner says a soda maker, which he declines to name, has teamed up with Wal-Mart in Britain to buy sugar. The soda company paid 14 percent less, he says. Wal-Mart's sugar costs also fell, savings it used to lower the price of bags of its own house brand of sugar.

In Chile, where Wal-Mart has 259 locations, the retailer teamed up with a paper supplier and managed to cut Wal-Mart's own paper costs by 2.5 percent because of the greater bargaining clout. Wal-Mart is also jointly purchasing rice and could extend the program to everyday products such as household cleaners, vitamins, and produce. "We can do this with anything that is sold," Muntaner says.

This is just the company's latest attempt at slowing expense growth. Wal-Mart is already consolidating its roster of suppliers, eliminating distribution middlemen in nations such as Japan, and taking over the U.S. trucking operations from some of its suppliers in a bid to haul goods more cheaply. International chief Doug McMillon says the company is saving hundreds of millions of dollars a year from such changes—and wants savings of over a billion dollars eventually.

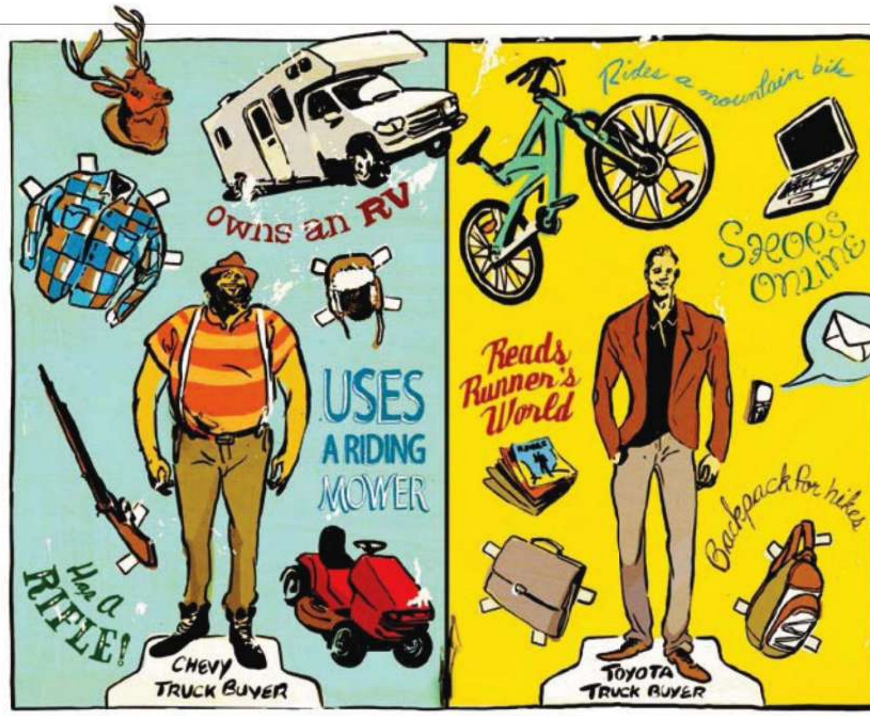
—Matthew Boyle and Carol Wolf

The bottom line *Wal-Mart is trying to increase its buying clout by teaming with suppliers to jointly purchase raw materials at better prices.*

Quoted

"It's simply a marriage made in heaven where one plus one equals not three, but four."
—Haim Saban, chairman of Spanish-language broadcaster Univision, on the $1.2 billion investment Mexico's Grupo Televisa is making in his company. Saban, with otherinvestors, took Univision private in 2007.





Autos

Toyota's Large-Pickup Identity Crisis

▸ The Japanese automaker isn't attracting traditional truck buyers

▸ "This is as red, white, and blue a market as there is"

For more than a decade the smart money said **Toyota Motor** and other Asian automakers would win over the outdoor-loving drivers of big pickups made by **General Motors** and **Ford Motor** and wrest control of that profitable U.S. market segment just as they had with cars. It never happened. The Japanese makers instead lured truck buyers who resemble car owners rather than die-hard truck lovers. Now sales of large pickups such as GM's Chevrolet Silverado and Ford's F-150 are rebounding, and Toyota and **Nissan Motor**'s failure to attract the truly devoted pickup buyers means less cash in their coffers.

"The Big Three successfully beat back the Toyota incursion into the pickup market," says Brian Johnson, a Barclays auto analyst who in 2007 predicted the Japanese company's success. "We had expected Toyota would do what they did with cars and take over the market. Their share gains have been frustratingly slow."

One reason: Toyota's full-size Tundra, which starts at $23,455, attracts a different type of buyer, data from Nielsen Claritas show. Toyota truck owners are 38 percent more likely to fly on business than typical drivers, and they lean toward hobbies like backpacking and mountain biking. Buyers of big pickups from GM, Ford, and **Chrysler,** however, are more likely to own a rifle to hunt than a bike to ride. Because that group of traditional truck buyers is so much larger, the Big Three has retained more than 90 percent of large pickup sales. It's a particularly lucrative win: Pickup profits range from $9,000 to $13,000 per vehicle, vs. $5,000 per car, Johnson said.

Sales for large pickups (weighing above 6,000 pounds) in the U.S. hit 2.2 million in 2007, only to plunge to 1.1 million last year—a 17-year low. Researcher IHS Automotive forecasts they'll surge 18 percent this year and hit 2 million again by 2016. Japanese automakers' market share will average only about 8.6 percent over that span, IHS predicts.

The cool response that Toyota—the world's largest auto company and America's largest producer of cars—has received to its big pickups has sent market researchers sifting through

THIS PAGE, FROM TOP: ILLUSTRATION BY CHRISTINA UNG; MATTHEW STAVER/BLOOMBERG. OPPOSITE PAGE, TOP: ROSS KINNAIRD/GETTY IMAGES

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sales data for demographic and psychographic clues to the causes of its disappointing performance. They found that GM and Ford truck owners, for instance, are more likely to dine at Cracker Barrel restaurants, have dial-up Internet, and use the paper Yellow Pages, according to purchase data from Nielsen Claritas. A much higher share of buyers of Toyota's big pickup dine at steakhouses, shop online, own golf clubs, and subscribe to magazines like *Runner's World,* the Nielsen data show. "Toyota planned for a [truck] market that really didn't exist," says Alan L. Baum, an auto analyst at Baum & Associates. "They just didn't hit a chord with buyers. It was almost comical."

While Toyota never expected to unseat either GM or Ford in full-size truck sales, even its goal of about 200,000, called "modest" in 2007 by then-U.S. chief Jim Press, has so far proved beyond its reach. Toyota initially planned for a capacity of as many as 325,000 Tundras. Similarly, Nissan said it hoped to sell at least 100,000 units of its full-size Titan truck when it entered the market in late 2003. Like Toyota, which has its pickup plant in San Antonio, Nissan built a $1.4 billion factory in Canton, Miss., to make the Titan. The company said the plant could shift to make even more of the trucks if demand exceeded its 100,000-unit goal.

Neither Japanese maker had to worry about maxing out its plant. Toyota's highest sales level was 196,555 Tundras in 2007, before output withered to 79,385 units in 2009. Nissan peaked at 86,945 Titans in 2005, dropping to just 19,042 last year. "Ultimately the group we were targeting wasn't quite as big as we expected," says Larry Dominique, Nissan's vice-president for North American product planning.

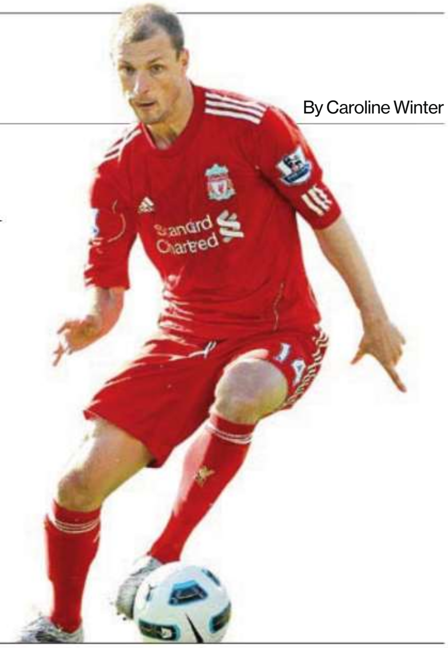
By contrast, GM has sold an average of 825,007 large pickups annually over the past decade, including the Chevy Silverado and Avalanche models and the GMC Sierra. Ford's F-Series models averaged 724,478, and Dodge Ram models averaged 339,448, according to IHS. Explains Tony Truelove, marketing manager for the Chevrolet Silverado: "This is as red, white, and blue a market as there is." **B**

—Jeff Green and Alan Ohnsman

The bottom line *Despite commanding America's passenger car market, Japan's Toyota has failed to attract traditional truck buyers to its large pickups.*

Briefs

By Caroline Winter



New England Sports Ventures
Snapping up England's Liverpool club

Liverpool, historically England's most successful soccer club, will likely be sold to New England Sports Ventures, parent company of the Boston Red Sox, for $476 million. The sale to NESV, a Boston-based company owned by billionaire John W. Henry, is still subject to English Premier League approval and a legal challenge from Liverpool owners Tom Hicks and George Gillett, who say the offer is too low. The five-time European champion, which won the last of its 18 English league titles in 1990, was put up for sale in April with debt of $558 million. Liverpool's owners bought the club for $350 million, including debt, in 2007. The deal is expected to be completed in mid-October.

American Express
Refusing to settle



On Oct. 4, Visa and MasterCard reached a settlement with the U.S. Justice Dept. that will allow merchants to use financial incentives to steer consumers away from using cards with higher transaction fees, which eat into a retailer's profits. American Express chose to fight a government antitrust lawsuit, saying a settlement would undermine competition in the payment industry. Those who accept Amex will remain subject to restrictions until the lawsuit is resolved.

Prada
Mulling a possible IPO in Hong Kong



Milan-based Prada is considering an initial public offering in Hong Kong in the first half of 2011, according to three people familiar with the situation. The high-fashion powerhouse may raise more money with a primary listing in Hong Kong than in Milan, as individual investors are more active in Asia, sources say. The company's sales may reach $2.75 billion in 2010.

Big Pharma
Under investigation for bribery

Federal investigators in the U.S. are probing Merck, Bristol-Myers Squibb, GlaxoSmithKline, AstraZeneca, and Baxter International over allegations that they paid bribes in foreign countries to boost sales and accelerate product approval, according to letters cited in *The Wall Street Journal*. Possible violations include bribing government-employed doctors to purchase certain drugs and paying regulators to win drug approvals. The probe targets transactions in Brazil, China, Germany, Italy, Poland, Russia, and Saudi Arabia, according to people familiar with the matter. SciClone Pharmaceuticals and Eli Lilly also said they have been subpoenaed.

New York Times Co.
Plans to repay Slim ahead of time

$250
MILLION

The New York Times Co. says it intends to pay back a $250 million loan from Mexican billionaire Carlos Slim by January 2012, three years ahead of schedule. The company borrowed the money in January 2009 at an interest rate of 14 percent, buying time to sell assets and refinance existing debt. The early repayment will save the company an estimated $100 million, according to its namesake paper. In the past two years, New York Times Co. has reduced its net debt to $670 million from $1.1 billion.

On the Move

- **Hewlett-Packard** Former SAP CEO Léo Apotheker named CEO
- **Skype** Cisco Systems executive Tony Bates appointed CEO
- **American International Group** Chief Risk Officer Robert Lewis steps down

Contents ▶ Where high-speed rail is pulling out of the station 28 ▶ The 13 high-speed rail corridors 29 ▶ Obama wants a détente with business 29
▶ Estate tax uncertainty makes for mega-generosity 32 ▶ Which financial firms will fall into the Fed's dragnet? 33 ● Edited by Paula Dwyer

Politics&Policy

Terry McAuliffe Pursues A New Shade of Green

▶ **Democratic fund-raiser aims to build a clean energy empire and create jobs in the South**

▶ **"What the Internet was for the 1990s, green jobs are for the 2000s"**

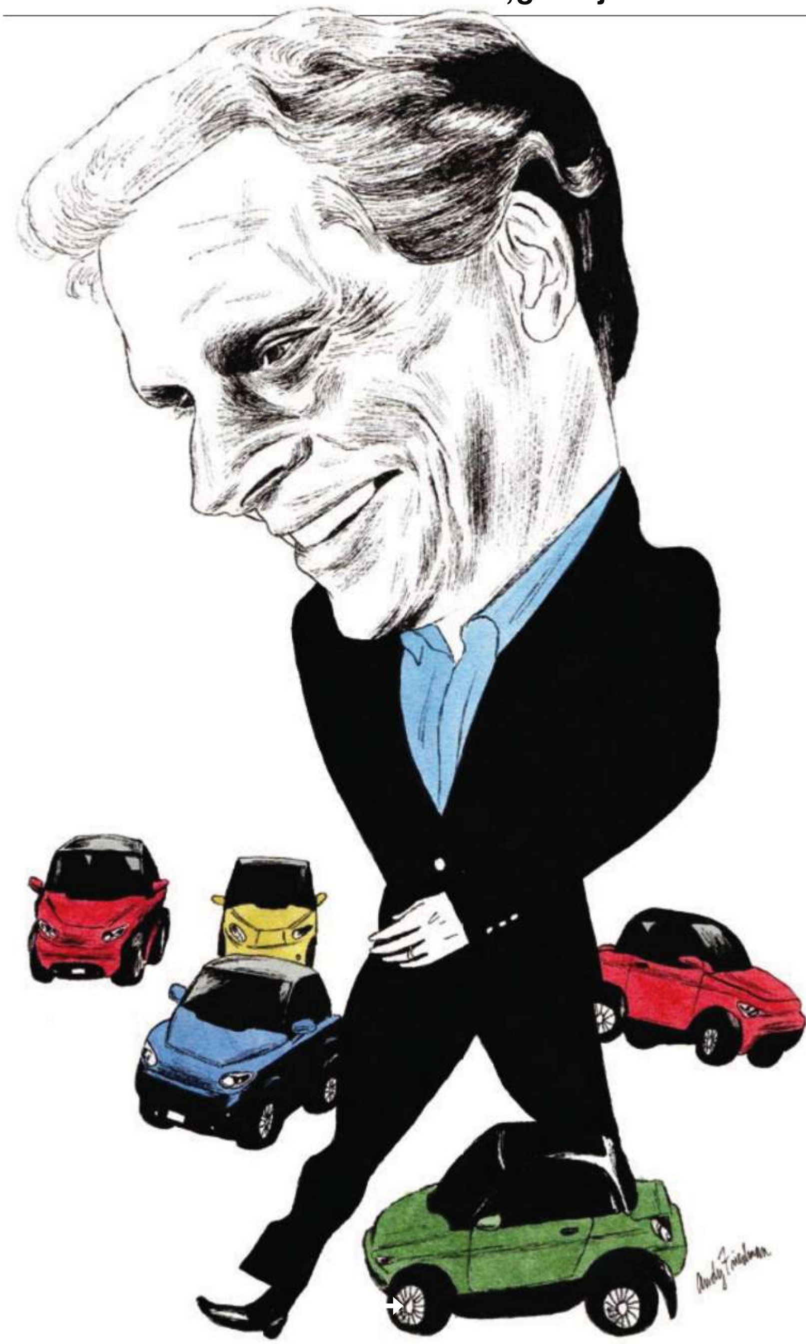


ILLUSTRATION BY ANDY FRIEDMAN

Photographers and tourists swarmed former President Bill Clinton as he admired a Day-Glo orange electric car, barely bigger than a golf cart, parked in Times Square. As cameras flashed, best pal Terry McAuliffe gave Clinton a personal tour of his latest project, proudly describing the tiny car's features as if it were a new baby. In many ways, it is.

Since 1980, McAuliffe has raised prodigious sums for lawmakers and Presidents and ran the Democratic National Committee. He made millions in real estate, banking, homebuilding, and credit cards, sometimes investing alongside the donors and union officials contributing to the campaigns he financed. He chaired Hillary Clinton's 2008 Presidential bid. And last year his ambition to become Virginia governor didn't survive the state Democratic primary.

McAuliffe's latest reinvention began in May when he bought the Hong Kong-based owner of MyCar, an all-electric two-seater made in southern China. He may be the Democrats' most famous, and most hyperactive, political salesman. But can he sell cars?

The MyCar is just one slice of an ambitious green strategy, which McAuliffe says will position him to do nothing less than help save American manufacturing, create thousands of middle-class jobs, reduce dependence on foreign oil—and, by the way, make some serious money. Not everyone is so sure.

Technically a "neighborhood electric vehicle," the MyCar accelerates to only 45 miles per hour, travels 70 miles before needing a recharge, and can't go on a highway. "If I were investing my money, I think I could find a better place for it," says Erich Merkle, president of the U.S. research firm Autoconomy. "[The car] is certainly more of a high-risk venture."

Where McAuliffe sees the national interest, skeptics see political ambition.

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Local officials wonder if a fighter like McAuliffe can ever really leave the ring—or if he's simply preparing for the next round. "The biggest criticism people had when he ran in the [Virginia] primary was that a lot of political people didn't even know he lived here because he didn't get involved locally," says Mame Reiley, who managed the campaign of Brian Moran, a primary opponent.

In the past year, McAuliffe founded **GreenTech Automotive**, which he aims to build into a $1 billion powerhouse. In February he bid to convert a shuttered paper factory in Virginia's southeast corner into a biomass power plant; he's awaiting word. He plans to invest up to $1 billion in wind power with a Chinese company, **A-Power Energy Generation Systems**. He says he's "jacked up" on fuel cells and is scoping out new technologies worldwide. "What the Internet was for the 1990s, green jobs are for the 2000s," says McAuliffe, sitting in his office surrounded by framed and signed photographs of inaugurations and conventions.

45
mph

The top speed McAuliffe's electric car can reach

This all began, he says, when he spotted the MyCar in London early this year. "I said to the guy, 'I'm not a carjacker, I promise you. If I give you $100, can I try this out?' " Brunch at J. Gilbert's, a northern Virginia steakhouse, with the management of EuAuto Technology, MyCar's owner, followed, as did meetings and legal reviews. GreenTech announced the EuAuto acquisition for an undisclosed sum at a May 17 news conference in Hong Kong, with U.S. Commerce Secretary Gary Locke.

McAuliffe then secured from Mississippi Governor Haley Barbour a package of state incentives to build a 400,000-square-foot facility in Tunica, Miss. Barbour, the former head of the Republican National Committee, is a longtime McAuliffe associate and former Washington superlobbyist. GreenTech plans to buy parts abroad and assemble the cars in the U.S., creating around 5,000 jobs in economically depressed areas. Besides Mississippi, McAuliffe is looking at sites in Tennessee and Virginia and says he'll go to the state offering the best tax breaks and other benefits. "You want this, you've got to offer incentives," he says. "I want to see legislation. That's part of our negotiations." Mississippi, Virginia, and Tennessee are right-to-work states, making it difficult for McAuliffe's workforce to be unionized. Union leaders were major donors to many Democratic campaigns McAuliffe financed.

When climate legislation died in the Senate last spring, green entrepreneurs were denied billions of dollars in government incentives they craved. McAuliffe says he plans to mount a lobbying campaign to revive some of the proposals, including federal tax breaks, requirements that electricity producers use renewable sources, and subsidies for stations where electric vehicles can recharge.

He expects the MyCar to go on sale in mid-2011, after it's modified to meet U.S. regulations and upsized for American consumers. The first 10,000 will sell for $10,000, with federal and state tax credits knocking the price down to around $8,500, he says. "No one can afford not to buy it," says McAuliffe.

Three more hybrid cars are planned for as early as 2013—a sports car, a mid-sized vehicle, and a subcompact. He won't disclose his backers, saying only that they are "strategic investors active in the green technology area." McAuliffe says he won't be tapping his sizable donor network. He has raised foreign capital through the EB-5 program, which offers permanent green cards to foreigners who invest $500,000 in distressed areas, producing 10 full-time American jobs. McAuliffe says he has attracted many investors this way, yet the total amount of money is "infinitesimal," considering the hundreds of millions he needs for the four cars.

The green strategy may be one way for McAuliffe to pay his political dues. "He could basically say, 'Virginia needs a governor who can go out there and sell the state, and I've done it,' " says former McAuliffe senior strategist Mo Elleithee. "It helps fill in a piece that was missing last time." McAuliffe says it's too early to decide his political future. "If you're asking me, am I going to walk away from what I believe will be a billion-plus company, I don't know," he says. "I don't, honestly." —*Lisa Lerer with Liza Lin*

The bottom line *Electric cars and other green ventures could be a comeback strategy for Terry McAuliffe, a would-be governor of Virginia.*

Transportation

It's Stop-and-Go for High-Speed Rail



▶ **Stimulus funds have jump-started rail lines in Illinois and Florida**

▶ **In 1919 "it took them three years to get the first dollar out"**

When President Barack Obama announced in January that 13 high-speed rail projects covering 22 states would share $8 billion in seed money, he spoke with optimism about easing highway congestion while bolstering the U.S. economy. Eight months later, some Republicans running for congressional or statehouses seats are singling out the funds, part of Obama's econom-

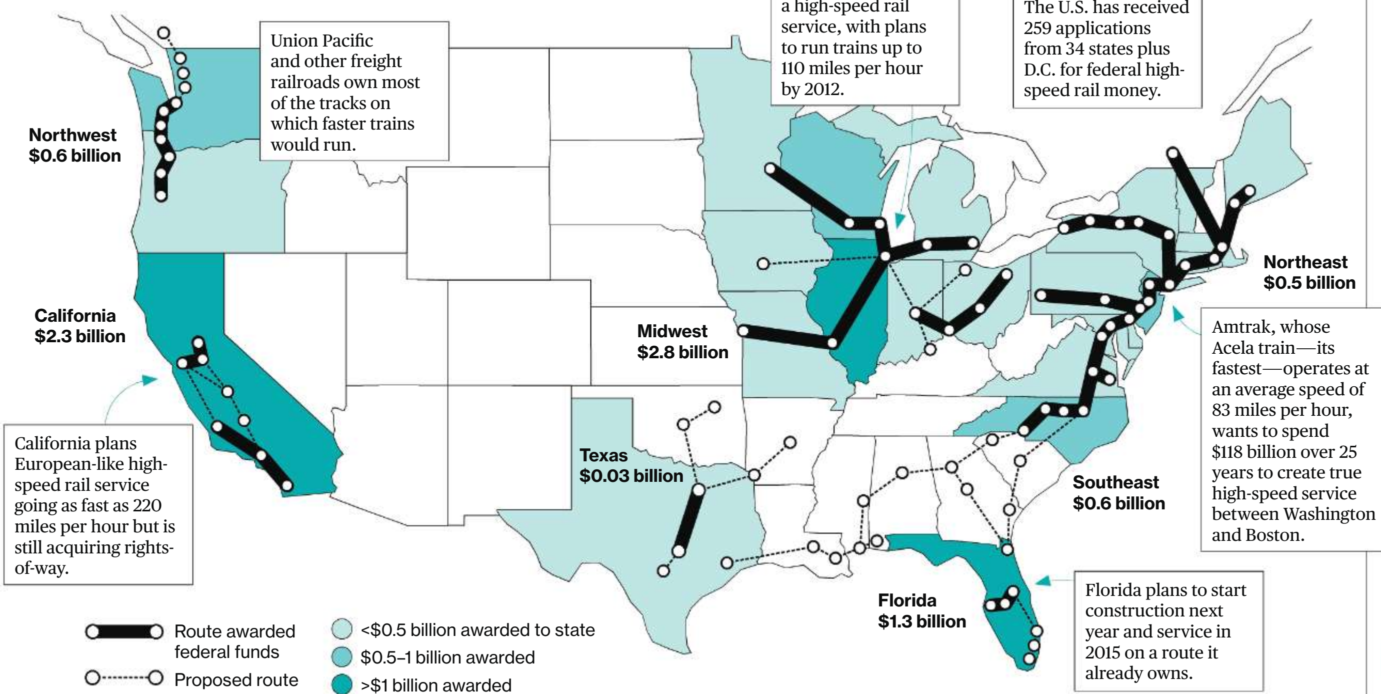
FROM LEFT: DONALD TRAILL/AP PHOTO; HIGH SPEED RAIL AUTHORITY/ZUMA PRESS

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High-Speed Rail Corridors in the U.S.

President Obama chose 13 projects over 22 states to receive parts of $8 billion in stimulus funds. The funding breakdown by region:



DATA: U.S. TRANSPORTATION DEPT.

ic stimulus package, as a waste of taxpayer dollars distributed too widely to do much good. A more practical obstacle has also emerged: Freight rail carriers that own some tracks are resisting sharing their lines.

Some of the projects are chugging along. As of Oct. 1, $883 million had been sent to six of the 13 projects, says the U.S. Federal Railroad Administration. California, Florida, and Illinois got the largest awards. The agency is parceling out the money as the states meet its requirements.

Obama's home state of Illinois may be the first to offer rapid service. With $1.2 billion in stimulus funds, Illinois began construction on Sept. 17 of a Chicago-to-St. Louis route, using track owned by **Union Pacific**, the biggest U.S. railroad. Trains will travel up to 110 miles an hour by 2012, ferrying passengers between the two cities in four hours. The quick action came in part because the route doesn't get much freight traffic, says Ed Hamberger, chief executive officer of the Association of American Railroads. When completed, the line may need subsidies, although a source has not yet been determined.

Florida, with a $1.3 billion award, could be next. Planners had the foresight to reserve space down the median of Interstate 4, between Tampa and Orlando, for rail service. Passengers will travel the 84 miles in 55 minutes. Construction is expected to begin next year and service in 2015, unless Rick Scott, the Republican nominee for governor, wins in November. Scott has said he won't accept stimulus funds for the project because it will require ongoing subsidies to operate.

California, where fast trains would run between Sacramento, San Francisco, and San Diego, had hoped to be right behind Florida. The state got a $2.3 billion stimulus award, and voters approved a $10 billion bond measure. California had planned a dedicated track for high-speed rail, some of it running alongside tracks owned by Union Pacific. But the railroad recently said it isn't willing to share the right-of-way along 200 miles of track.

Karen Rae, the rail administration's No. 2, defends the agency's decision to fund so many projects at once. "It's not easy to just create something from cloth," Rae says. "If you go back to 1919 when they had the bureau of public roads, it took them three years to get the first dollar out." *—Angela Greiling Keane, with Michael Marois*

The bottom line *High-speed rail projects are running into political roadblocks, yet some states are barreling along.*

The White House

Obama Wants a Détente With Business

▶ The Administration plans to push the reset button early next year

▶ "The President doesn't consider business a noble profession"

Last fall, **JPMorgan Chase** Chief Executive Officer Jamie Dimon showed White House staff a chart comparing the percentage of Cabinet Secretaries and top aides with business experience under Administrations going back to Teddy Roosevelt. President Barack



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Obama had the fewest by far. The President's sometime adversarial relationship with business wasn't helped by the departures of Chief of Staff Rahm Emanuel and National Economic Council Chairman Lawrence H. Summers. Exasperated executives often consulted the two aides, even if the lines of communication weren't always clear. "The fundamental problem," says Steve Reinemund, former PepsiCo CEO and now dean of the Wake Forest University School of Business, "is the sense the President doesn't consider business a noble profession."

Democrats close to the Administration say the White House wants to make amends and will make its relationship with business a priority after the midterm elections. "I have every expectation as we go through the next several months that we are going to see a greater involvement with business than we have seen in some time," says Tom Daschle, the former Senate Democratic leader and an Obama ally.

The changes could include Obama's backing of proposals to cut payroll taxes temporarily, which could save companies billions, according to company executives, economic advisers, and White House aides. If his deficit commission in December recommends a debt-shrinking package of spending cuts and tax code changes, including corporate tax reform, Obama may support it, the people say. The White House may also consider naming a CEO to a Cabinet job if one opens up or may give someone business finds credible the role of counselor, with a wide-ranging portfolio, they say.

Daschle says Peter M. Rouse, Obama's new chief of staff, who has few business connections after spending most of his career managing the staffs of Democratic lawmakers, plans to be more accessible to corporate executives. "I don't think there's any question that he's aware of that criticism and aware of the need to be more interactive and engaged with the business community," says Daschle, Rouse's former boss. "I would not be surprised at all if you saw evidence of that quite soon."

By many objective measures, most businesses are thriving and should have little to complain about. Corporate profits rose to a record $1.38 trillion in the second quarter, according to the St. Louis Federal Reserve. The Dow Jones industrial average is up more than 38 percent since Obama took office.

38%

Increase in the Dow Jones industrials since Obama took office

So why the criticism? "There is a venerable tradition of business being antagonistic to Democrats, even in instances when the policies are advantageous to them," says Fred I. Greenstein, a professor emeritus at Princeton University and author of books on Presidential leadership. The strain between the Administration and business "was similar for FDR, which was the period of the last great reregulation of the economy," says Bruce Buchanan, a professor of government at the University of Texas at Austin, referring to Franklin D. Roosevelt's New Deal. "And there is an element of hurt feelings to it as well, which surprises me." Despite numerous meals with business leaders, the President seems to approach the relationship in a detached fashion, as if he were checking off a box, say executives who requested anonymity in order to speak freely.

Austan Goolsbee, the President's top economist, will try patching up relations in an Oct. 13 meeting in New York with business leaders. A rapprochement, however, will not occur until after the midterm elections, when the Administration will know the strength of the Republican opposition in Congress. That timing also will help Obama avoid looking like he's giving Wall Street a pass just

Quoted

"More and more countries face stronger pressure to lean against the market forces pushing up the value of their currencies."
—Treasury Secretary Timothy Geithner on Oct. 6, warning countries that a currency war, in which countries stop their currencies from rising in value, risks undermining the global recovery



MANUEL BALCE CENETA/AP PHOTO



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Politics&Policy



Ellison: Smack talking the competition page 35 ▶



Obama, flanked by Emanuel and Rouse, is looking to improve ties with business

when he's trying to turn the Democratic base out to vote. At an Oct. 4 meeting of Obama's economic advisory board, Laura D. Tyson, a former Clinton Administration economist, suggested not renewing the Bush tax cuts for top earners and using the savings to pay for a temporary cut in Social Security taxes. At the same meeting, Obama said he'd be "very interested" in lowering the top corporate tax rate, now 35 percent, so U.S. companies aren't at a disadvantage against overseas rivals.

Business should be prepared to make trade-offs. Cutting corporate taxes, for example, would likely be paired with closing loopholes that companies use to lower their tax rate so that any proposal is revenue-neutral. Business was unwilling to accept such a trade-off in August, when Obama proposed giving companies tax breaks for research and capital investment. The U.S. Chamber of Commerce and the Business Roundtable rejected that because companies' overseas taxes would increase to offset the cost. "The new taxes would negate the intended effects of these new policies," Business Roundtable Executive Director Larry Burton said on Sept. 8. Says Princeton's Greenstein: "You never get everything you want."
—Julianna Goldman, Hans Nichols, Mark Drajem, and Lizzie O'Leary

The bottom line *After the November elections, the White House plans to try to make up with business following months of strained relations.*

Taxes

Don't Throw Momma From the Train

▶ Large gifts this year will avoid huge estate taxes next year

▶ "This is going to be the craziest yearend ever"

An 84-year-old widow gathered her children at the Chicago office of the McDermott, Will & Emery law firm recently and told them they were going to get a special Christmas gift this year: half her $20 million fortune.

The decision to pass on her money while still alive was prompted by the congressional deadlock over renewing Bush-era tax cuts that could make providing for her heirs prohibitively expensive if she dies after Dec. 31. Estates are exempt from tax this year, and the rate shoots up to 55 percent next year unless lawmakers act in a post-election session.

Short of a timely death by Dec. 31, the only way families may avoid a huge increase is with a gift. This year the gift tax is a historically low 35 percent, equal to the top marginal rate on ordinary income. It, too, jumps to 55 percent next year. Families can lock in the lower rate by making gifts before Jan. 1. "She said, 'I don't want anyone wishing I was dead,'" says the widow's lawyer, Domingo Such, who declined to identify his client.

The repeal of the estate tax this year—the economist Paul Krugman has called it the "Throw Momma from the Train" law—has generated much black humor about unfortunate accidents befalling wealthy parents as Dec. 31 approaches. Such says his client made a clear-headed bet that she could reduce her tax bill by as much as 40 percent by rewarding her heirs immediately. "This is the lowest rate that the gift tax has ever been at; it's only going to get higher," he says.

Lawmakers have long matched the gift-tax rate with estate taxes to prevent the wealthy from ducking the IRS. Gifts of more than $1 million usually are taxed at the same rate as estates—except for this year. The rates were set in 2001 as part of an effort by then-President George W. Bush and his GOP allies to abolish the estate tax. After opposition from Democrats, they had to settle for a gradual reduction over a decade, culminating in a one-year repeal for 2010.

Joshua Rubenstein, head of the estate and trust practice at New York's Katten Muchin Rosenman, says many wealthy people are hedging their bets by waiting until late December to transfer large sums to heirs. That's in case the giver dies before Dec. 31, in which case a tax was needlessly paid. "This is going to be the craziest yearend ever," Rubenstein says. *—Ryan J. Donmoyer*

The bottom line *This year's 0 percent estate tax, which zooms to 55 percent on Jan. 1 unless Congress acts, has some families resorting to mega-gifts.*

Taxing Calculations

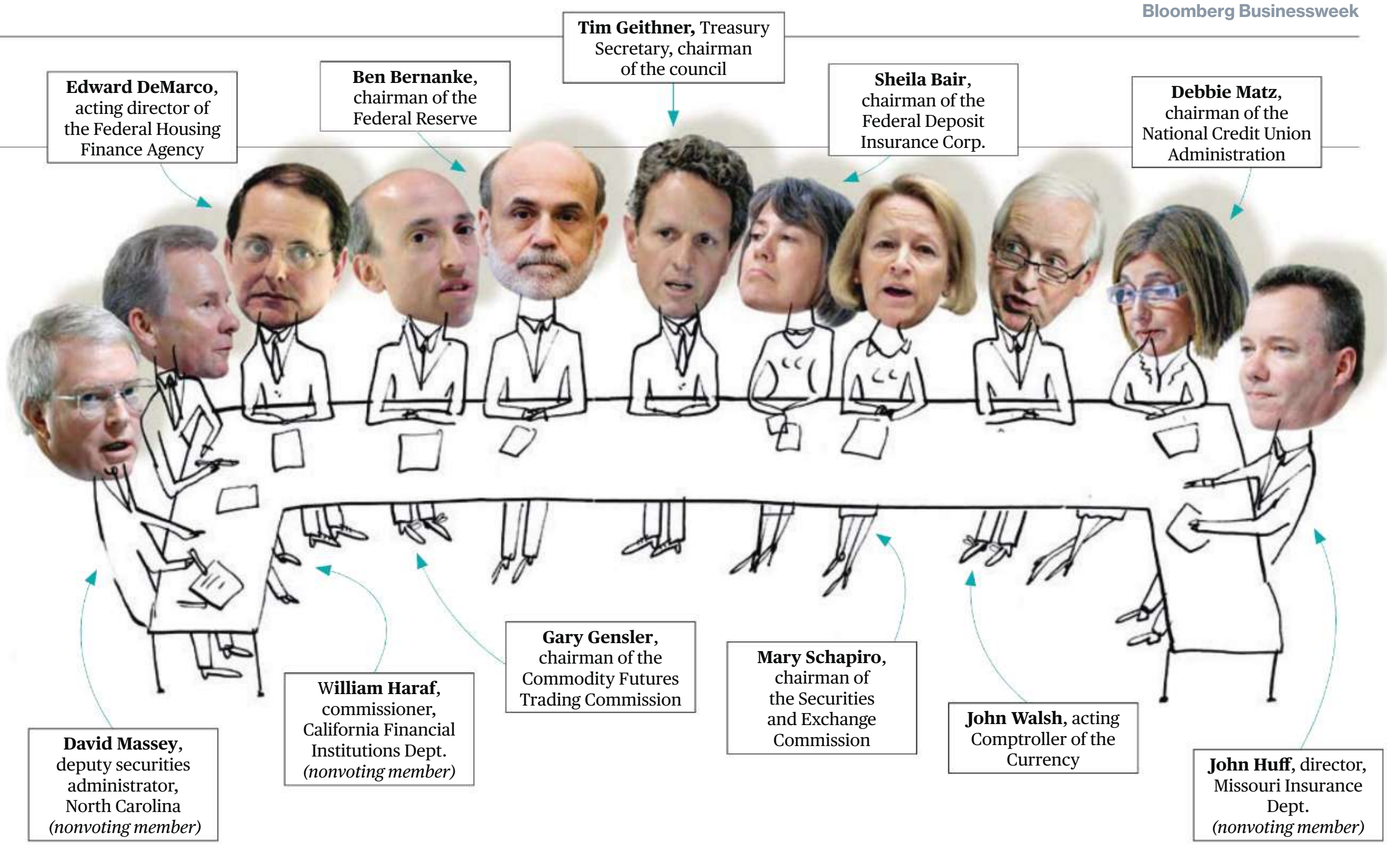
	Current Top Rates	Top Rate as of Jan. 1	Obama Proposal	Bipartisan Proposal*
Estate Tax	**0%**	**55%** on estates of $1 million and more	**45%** as of Jan. 1, exempting the first $7 million	**35%** as of Jan. 1, exempting the first $10 million
Gift Tax	**35%**	**55%** on gifts of $1 million and more	**45%**	**35%**

*As proposed by Senators Jon Kyl (R-Ariz.), Blanche Lincoln (D-Ark.), and Mitch McConnell (R-Ky.)

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Financial Regulation

A New Council Looks For Risky Business

▶ Hedge funds, private equity, clearinghouses are under scrutiny

▶ "There's going to be a lot of controversy once they start"

It has the makings of a Wall Street parlor game: Guess which firms will be designated for Federal Reserve oversight because they could pose a risk to U.S. financial stability.

A council of regulators, which met for the first time on Oct. 1, will review non-bank financial companies for possible inclusion under the Fed's regulatory umbrella, taking into account everything from size and debt to hidden liabilities. U.S. bank holding companies with more than $50 billion in assets–about 35 in all, including **JPMorgan Chase** and **Goldman Sachs**–are automatically included.

A large number of hedge funds, private equity firms, and derivatives clearinghouses could also be considered. **GE Capital**, General Electric's financial arm, has said it expects to be included. Its operations include the biggest issuer of store-brand credit cards in the U.S., aircraft leasing, small-business lending, and commercial real estate. **American International Group**, which during the 2008 crisis became the symbol of a lightly regulated conglomerate and an inspiration for the new Financial Stability Oversight Council, could also be included.

Treasury Secretary Timothy Geithner, the council's chairman, suggested both companies would be on the list when he said on Sept. 30 that the Dodd-Frank law imposes stricter oversight on entities "that are banks in all but name, whether you call them investment banks, or AIG, or GE Capital." Such firms may be forced to "run with a much more conservative, prudent leverage and funding mix," he said.

Atlanta-based **IntercontinentalExchange**, which owns a derivatives trade-processing operation, and New York's **Depository Trust & Clearing Corp.**, which completes stock trades, may be tapped, say former Treasury officials, regulatory lawyers, and analysts. **Citadel**, which is the biggest shareholder in E*Trade Financial and has a small investment bank, could also come under scrutiny, as could **Blackstone Group**, the world's largest buyout firm, they say. Companies that consumers depend on heavily, including insurers and credit-card companies, might also come under heightened inspection. Although they aren't exempt, mutual funds may escape scrutiny because they typically take on less risk than hedge funds. Citadel, AIG, Blackstone, and the clearing firms declined to comment.

It's unclear whether Fed supervision will be a cost or a benefit. "Investors may perceive you as being so carefully watched that you're a safer investment, and that reduces your cost of funds," says Wayne Abernathy, an executive vice-president at the American Bankers Assn. and a former Treasury official. "The downside is a certain amount of new, heavy regulatory burden comes with it."

Rules about how the designations will be made are due in spring. It may be a challenge for the council to ignore public opinion when deciding who falls under the new regime. "There's going to be a lot of controversy once they start doing this, and the decisions will be very difficult to defend," says Hal S. Scott, a Harvard Law School professor. "When the first one is designated," he says, "everyone's going to ask why them and not us, or why us and not them." Ⓑ

—Ian Katz with Rachel Layne

The bottom line *A new council of regulators is scrutinizing financial firms to find those that should be subject to Fed oversight because they are high-risk.*

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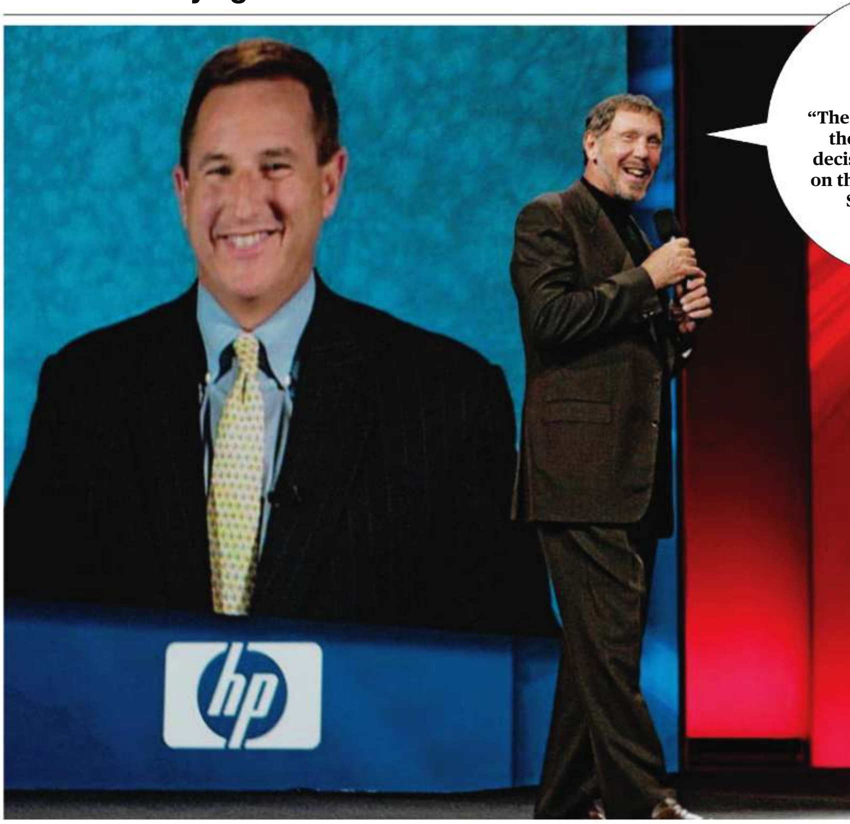
Contents
▶ Unicom: The network Chinese iPhone users love to hate 36 ▶ A field guide to Valley takeover bait 37 ▶ Why iPads are free in Taiwan 38 ▶ Charlie Rose talks to Twitter CEO Dick Costolo 39 ▶ Innovator: Ronald Blum on his electronic eyeglasses 40 ● Edited by James Aley

Technology

...And Finally, My New No. 2 Is Way Better Than Yours

▶ **Oracle's Larry Ellison returns to his old strategy of ridiculing the competition**

▶ **"He is now trying to drive the value of HP down"**



PAUL SAKUMA/AP PHOTO

Ellison on the dismissal of Hurd (far left): **"The HP board just made the worst personnel decision since the idiots on the Apple board fired Steve Jobs many years ago."**

Thank heavens for Larry Ellison. Without the smack-talking **Oracle** co-founder and chief executive officer, the $1 trillion-a-year enterprise computing market would merely be huge, crucial—and boring. Oracle and fellow tech titans like **IBM**, **Hewlett-Packard**, and **Cisco Systems** make the technology that runs major corporations around the world. But the intricacies of their products can put regular folks to sleep faster than a Senate hearing on Net neutrality.

After what seemed like an uneventful interregnum in which Ellison kept his swipes largely to himself, the rabble-rouser of Redwood Shores, Calif., is acting out once more. In the past two months alone, Ellison compared the HP board to "idiots" for firing Mark Hurd, hired Hurd, then again ridiculed HP's directors when they brought in a new CEO. In an e-mail to *The Wall Street Journal*, Ellison called the selection of former SAP chief Léo Apotheker "madness" and said HP's whole board should resign. He even made fun of **SAP** co-founder Hasso Plattner's "wild Einstein hair." (Although, to be fair, Plattner did moon Ellison years ago during a sailboat race.) The Oracle chief "basically says to all players, 'I am your enemy,' " says Marc Benioff, CEO of **Salesforce.com** and a former Oracle executive, who himself has been the target of several Ellisonian barbs over the past few weeks.

On HP's new CEO: **"They pick a guy who was recently fired because he did such a bad job of running SAP. ... The HP board needs to resign en masse."**

Ellison's oratory is more than just entertaining Silicon Valley street theater—it also speaks to increased competitive tensions in the enterprise computing business. The IT arena these days is a little like a game of bumper cars, with big companies in once-adjacent sectors of the industry now relentlessly colliding. Hardware makers such as **Dell** and HP are getting into software, and software companies like Oracle are getting into hardware. The goal is to be able to sell software in tandem with computer hardware and help corporate customers tackle complex tasks like managing global shipments of components or gleaning new insights from data.

"We had 15 years of relative peace where everyone had their own patches and you had all these wonderful camps and coalitions," says James Alexander, senior vice-president of Info-Tech Research Group. "Now these guys need to keep driving top-line revenues and market share, and the only way to do that is through acquisitions and getting into somebody else's business."

Ellison, the world's sixth-richest man, wears his corporate strategy on the sleeves of his tailored Italian suits. Think of his colorful outbursts as a map of Oracle's ambitions. Next year, Oracle plans to deliver a suite of business applications called Fusion to replace an aging collection of software it owns from acquisitions of PeopleSoft, Siebel ➜

Technology

The fallout from faulty foreclosures page 43 ▶



Systems, and other companies. That will put Oracle into closer competition with Salesforce.com, whose online software helps companies manage customer relationships over the Web. Thus, the Benioff-bashing. During his keynote at the annual OpenWorld conference for customers last month, Ellison slapped up a slide that digitally altered the title of Benioff's 2009 book, *Behind the Cloud*, to read *Way Behind the Cloud*. Benioff says he has some admiration for his former boss's tactics. "One of the things he's done with Oracle, which is a relatively boring database company, is focusing on the most exciting things," Benioff says. "It's a tremendous skill that he has." Oracle spokeswoman Deborah Hellinger declined to comment.

On competing with SAP: **"Just like we beat them badly in middleware, they have even less of a chance to beat us in databases."**

If the volume of Ellison's attacks is any indication, he views HP as a far greater threat. Both companies want to create the integrated hardware and software systems that can satisfy a corporate customer's every IT need. With that goal in mind, Oracle paid $7.4 billion for Sun Microsystems in 2009, outbidding IBM. Ellison told analysts last month that he would consider buying a chip company, which helped lift the stocks of semiconductor makers.

On Bill Gates: **"Referring to Gates as the smartest man in America isn't right. ... Wealth isn't the same thing as intelligence."**

Rob Enderle, a longtime tech industry consultant, believes Ellison had once hoped that HP would sell Oracle some of the necessary pieces to combat his greatest foe, IBM. "HP is the only property out there that would allow him to take on IBM in what remains of his working lifetime," Enderle says. "The only thing that makes sense is that he is now trying to drive the value of HP down or force HP's board into a more collaborative position."

HP, like Oracle, has also been expanding its business, shoring up its presence in software and mobile computing. It bought Palm for $1.2 billion in April and beat Dell last month in a bidding war over **3Par**, paying $2.4 billion for the data storage vendor. HP hired Apotheker as CEO primarily for his background in software and his experience running a large global business, says a person close to the hiring process. Ray Lane, the venture capitalist who was Oracle's president in the '90s, will become chairman of HP and is an avowed Ellison rival. "I don't think they'll hesitate to hit back against Oracle," says Bill McDermott, co-CEO of SAP, who joined the company in 2002 and was mentored by Apotheker. "Both of them are very capable of doing that."

Analysts believe HP's new hires could help it work more closely with SAP to create a mega rival to Oracle. "HP and SAP are relatively good partners anyway, but there is always potential for them to get closer," says IDC analyst Al Hilwa. That may be Ellison's worst nightmare, but it would be great for customers and Silicon Valley's armchair observers. It would mean more intense competition, more price-cutting, and almost certainly more entertainment courtesy of Larry Ellison.
—*Brad Stone and Aaron Ricadela*

The bottom line *Larry Ellison's public attacks on rivals aren't just theater—they're a barometer of heightened competition in enterprise computing.*

Networks

China Unicom Has An AT&T Problem

▶ Chinese iPhone users are upset with Unicom's spotty coverage

▶ "Everybody hates them," says one Hong Kong analyst

For iPhone users in the U.S., the gripes of their Chinese counterparts may sound all too familiar. Dropped calls. Spotty coverage. Lousy customer service. In the U.S., the telecom network that **Apple** fans love to hate is **AT&T**. In the People's Republic, it's **China Unicom**. The state-owned company is the only Chinese mobile carrier with the type of 3G network that works with the iPhone. Problem is, Unicom is a longtime also-ran, far behind market leader **China Mobile** and notorious for running a network that drives customers up a wall. "Everyone hates them," says Paul Wuh, an analyst in Hong Kong with Samsung Securities.

Unicom's reputation is so bad that many Chinese iPhone owners are willing to alter their handsets—and lose access to many iPhone apps—rather than sign up with the company. Unicom's challenge "is convincing users they won't have to lean out ➔



An iPhone 3GS user captures a China Unicom scene in Chenzhou

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M&A

A Field Guide to Silicon Valley Takeover Bait

Cisco, Dell, HP, IBM, and Oracle are all racing to catch the next tech megatrend: cloud computing. They're also sitting on a combined $100 billion in cash. So M&A speculation runs wild. Midsize companies such as McAfee and 3Par have already been snapped up at lofty valuations. We spoke with analysts and executives to see who might be acquired next and by whom. —*Peter Burrows and Joseph Galante*

Networking

F5 Networks

$8.3 billion*

Technology that directs information from the Net to available servers inside data centers. An "attractive pickup" for anyone up against Cisco, says ThinkEquity's Rajesh Ghai. **Fits with:** HP, Oracle

Brocade Communications

$2.5 billion

Specializes in gear that moves data between storage devices. Execution snafus pushed down its stock, raising its odds of getting bought. **Fits with:** IBM, Oracle, Dell, HP

Brocade MLX Series router



Riverbed Technology

$3.2 billion

Software for cloud computing often runs in faraway server farms rather than in an office computer room. Riverbed's gear cuts the data's travel time. **Fits with**: HP, Cisco

Arista Networks

Private

High-end routers designed for cloud computing. Founded by famed engineer and investor Andreas Bechtolsheim and Jayshree Ullal, former head of Cisco's data center business. **Fits with:** HP, Oracle

Aruba Networks

$2.1 billion

Makes wireless systems for businesses so employees have access to their company network whether they're at their desk, in the cafeteria, or anywhere else on a corporate campus. **Fits with**: HP, Cisco

Software

VMware

$32 billion

Its virtualization software lets companies get more work out of fewer servers. Cisco has shown interest, though it may need to buy VMW's majority owner, EMC, to do so. **Fits with:** Cisco, HP, IBM



VMware Fusion 3 for Mac

BMC Software

$7.1 billion

Data center operators use BMC's software as a virtual dashboard to coordinate all the machinery and applications they oversee. HP and IBM provide similar products. **Fits with:** Dell, Cisco, Oracle

Citrix Systems

$11.4 billion

The cloud computing pioneer's software lets workers control office PCs from the road. One tech CEO says Microsoft might counter any rival's offer for Citrix. **Fits with:** Cisco, HP, IBM, Microsoft

Sourcefire

$806 million

Open-source security specialist: Any client (or lone geek) can tweak their code. Sales rose 37 percent in 2009, outpacing rivals such as Fortinet and Websense. **Fits with:** Oracle, IBM , HP

Tibco Software

$3 billion

Companies often run back-office programs on separate systems old and new. Tibco Software helps unite it all no matter what the computers' vintages. **Fits with:** IBM, Oracle, HP

Hardware

Teradata

$6.3 billion

Data mining to help companies tease meaning out of petabytes of info. Once run by Mark Hurd, who tried–and failed–to take it on while he was chief executive officer of HP. **Fits with:** HP, Dell

Mellanox Technologies

$658 million

Oracle's Larry Ellison says he may buy chipmakers. Mellanox's chips use the InfiniBand standard, which connects servers with storage gear and is already used by Oracle. **Fits with:** Oracle

Dot Hill Systems

$88.5 million

Money-loser in a hot market: storage. Laid off 10 percent of its staff to get profitable by 2011. That will depend in part on how well it integrates software from a recent acquisition. **Fits with**: Dell, HP

Check Point Software

$7.7 billion

Israeli firewall pioneer. Backed off a 2005 bid for Sourcefire due to U.S. objections; Tel Aviv may similarly oppose Check Point suitors from the U.S. **Fits with:** HP, Dell

Isilon Systems

$1.4 billion

Software that stores and retrieves video and other media. Hired banker Frank Quattrone to whip up buyer interest after HP bought money-losing rival 3Par. **Fits with:** Dell, HP, Oracle

Isilon Systems' Accelerator node



*MARKET CAP

a window to make a call," says analyst Mark Natkin of Marbridge Consulting, a Beijing-based market research firm.

Here's how the Unicom end run works: Users buy iPhones from Apple stores in Beijing or Shanghai or at nationwide retailer **Suning** and get a China Mobile service contract if they don't have one. Then they take their China Mobile SIM card (the chip that identifies a phone to a cell network) and snip it down to the smaller shape that iPhones use. Those iPhone users then have to settle for China Mobile's slower 2.5G network. (China Mobile has a 3G network that can't run the Apple gadget.)

Vincent Luo, a 30-year-old office worker in Shanghai, bought an iPhone 3G while traveling in Singapore in January, and signed up with China Mobile when he got home. The slower data speeds mean data-intensive apps don't run very well–online video is choppy, for example. "But the signal is much stronger," he says. "I don't want to switch to Unicom." A Unicom spokesperson declined to comment.

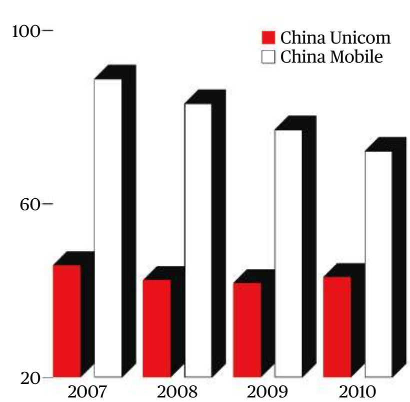
Unicom wasn't Apple's first choice as a network provider in China. Apple Chief Executive Officer Steve Jobs signed off on teaming up with the company only after on-again, off-again talks with China Mobile went nowhere. In 2009, Apple signed a three-year agreement with Unicom, making it the only Chinese carrier authorized to sell iPhones. Unlike Apple's deal with AT&T in the U.S. or carriers such as **Softbank** in Japan, the alliance doesn't prevent Apple hardware from working with other carriers. With the Sept. 17 launch of the iPad in China, Apple moved to distance itself from its erstwhile partner, offering the tablet computer with Wi-Fi (which doesn't require a carrier to work) rather than a 3G option that would tie users to Unicom.

Unicom is spending big to improve its image. The company on Sept. 28 sold $1.84 billion in convertible bonds, with the proceeds going to build out the carrier's network. Over the past three years, says Samsung's Wuh, Unicom has spent more than $22 billion to boost its network and plans on spending $7.5 billion more. The company is addressing the problem now, "but network coverage takes a fairly long period of time to perfect," says Wendy Liu, an analyst in Hong Kong with RBS. "They've never had enough money to grow as they wish."

The company is starting to win over some skeptics. On Sept. 25, Unicom began selling the iPhone 4 and reported strong demand, with orders for 200,000 handsets in a few days. The company looks forward to "sustainable, rapid, and healthy growth," Chairman Xiaobing Chang said in a Sept. 28 press release. If it can ever get its network reliability up to snuff, the operator Chinese love to hate might finally start winning some friends. —*Bruce Einhorn*

***The bottom line** China Unicom needs to upgrade the reliability of its network to repair its poor quality image and win the loyalty of mainland iPhone users.*

Monthly Average Revenue Per User
(in Chinese yuan)



DATA: RBS

90
MILLION DOLLARS
Maximum amount Verizon Wireless says it will pay 15 million customers for overcharges

DATA: VERIZON WIRELESS

E-Commerce

Where iPads Are Free, And Cases Cost $1,000

▶ Apple's tablet isn't licensed in Taiwan yet, creating a gray market

▶ "I am not selling iPads, I am selling iPad cases"

In Taiwan, a good way to find deals on electronic gear is to troll online auction sites. For example, on a **Yahoo!** Auctions page run by a seller named Tsang, one deal stands out among the **Samsung** smartphones, **Bose** sound systems, and hundreds of other products on display: an iPad case for NT$33,000 ($1,063). Although that's about 2,600 percent more than what **Apple** charges for the same case on its U.S. website, by local standards it's not a bad price. That's because if you buy the case, Tsang, who would only provide her surname, will throw in a free iPad with 3G wireless and 64 gigabytes of memory. She says the case is her hottest item.

Selling iPads in Taiwan is illegal, so gray marketeers are giving them away with the purchase of absurdly marked-up accessories. It's like selling a set of tires for $50,000 and including a BMW at no extra charge. The country's National Communications Commission, which issues licenses for all wireless devices, has yet to approve the tablet. It's perfectly fine to bring iPads into the country if they were bought elsewhere, however. Tsang and more than a dozen enterprising auction-site sellers figure that gives them a loophole: As long as they charge for the case and not the thing that goes inside it, they figure they're not breaking the law.



2,600%
Markup of case sold in Taiwan over U.S. price

Actually, they are breaking the law, says Tseng Shian-kang, a public-relations official at the NCC, though he adds that the commission has no plans to prosecute. (According to

FROM TOP: KIM WHITE/BLOOMBERG; BRAD TRENT

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Charlie Rose talks to
Dick Costolo



PHOTOGRAPH ILLUSTRATION BY CREDITTK

Twitter's newly appointed CEO on the road ahead, the differences between his company and Facebook, and the prospects for profitability

Tell me what you think the challenge is for you and this company.
It's one thing to have to manage growth in your home country. We're seeing tremendous growth across Asia in Japan and Korea. We're seeing tremendous growth in Brazil. We're seeing tremendous growth in Latin America. So [we're] having to deal with growth in multiple countries around the world on multiple axes—technical and user and monetization. Very few people have had to deal with anything like this before.

Why the leadership change?
We started to realize that when [outgoing CEO Evan Williams] has a chance to focus solely on product strategy, which is his passion, we have these incredible results. At the same time, we've got this management team in place ... a CFO who was CFO at Pixar previously, we've got a vice-president of engineering who's had tremendous experience. So Ev and I and the rest of the board realized that now is the right time to do this.

You said: "I think Twitter needs to accomplish more in the next two years than it has in the previous four." What kinds of things does it have to do?
The answer to that is one of the historical questions we've always had: "How do you guys think of yourself vs. Facebook?" And it's become more and more clear to us over the past couple of years that the differences are growing between us. They're a social network. You know, "I'm a friend of yours, and you're a friend of mine."

We think of ourselves more and more as something completely different. Evan has described it as this real-time information network. We saw that with the terrorist attack in Mumbai where people even started tweeting. ... "Don't tweet where the anti-terrorist forces are because the terrorists might be using Twitter." And then we saw it during the Iran elections when the distance between the Iranian people and the rest of the world was compressed by Twitter. So everyone around the world was able to see—even though the Iranian news agencies were blocking all the outgoing news sources—exactly what was happening in Iran in real time.

Did anyone see this political impact coming?
I didn't. I think one of the amazing things about Twitter has been the way in which it's evolved organically.

When you imagine where it might be in five years, what—beyond simply an expansion—do you picture?
One of the things that we're seeing is that there's just more and more information coming at people on Twitter. And so we've got to do a better job of filtering that information. People have devices in their homes now that tweet. You know, weight scales that tweet, tennis shoes that tweet out how fast you ran your 5K, an armband that tweets how long you slept last night. One of the things that we'll have to do a much better job of is providing filters for that information, both human-curated filters and algorithmic filters.



How do you monetize it?
The short answer to how we monetize is we have an advertising platform that is organic to the service. And what I mean by organic is that ads have to be content first in Twitter before they can become ads. If Virgin America, the airline, sends a tweet out that they just opened service to Toronto and you can get a 30 percent discount by flying to Toronto, their followers get that for free, just like your followers and my followers get our tweets for free. But they can also then say when people search Twitter for certain keywords, like "travel" or "vacation" or "flights"—and people search Twitter a lot—they can pay us to have that tweet show up in front of all those people.

Will you take an independent route and perhaps go public as Facebook seems to be, or will you look at some acquisition route like YouTube?
We have every intention and desire to remain an independent company.

How will Twitter change the world?
It doesn't have to be political strife. It can be things like making it easier for people to understand the impact that certain charities can have. We've seen DonorsChoose use the platform of Twitter to great success. We've seen charity: water [a nonprofit] make it very easy for people to understand how donating helps get actual wells built in Africa. One of the challenges charities face is this distance between the donation and the result. We hope those folks are able to do on Twitter what the platform did for the Iran election, compress that distance.

Is 140 characters sacrosanct?
A hundred and forty characters is sacrosanct.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

Technology

the NCC, Yahoo is legally in the clear. "We follow government regulations and patrol the site," says Sophia Cheng, a spokeswoman for Yahoo in Taiwan.)

Consumers bought 7.9 million iPads worldwide through the end of September, according to investment bank Janney Capital Markets. Tim Cook, Apple's chief operating officer, has said the Cupertino (Calif.)-based company is selling them "as fast as we can make them." (Apple declined to comment for this story.) Rather than exacerbate supply problems by offering the iPad in all countries at once, Apple has been rolling the device out in phases. Last quarter the tablet became available in Singapore and China. At some point, iPads will go on sale in Taiwan, too. "Apple submitted their application in August and we're still processing it," says the NCC's Tseng. "We don't know when it'll be approved."

7.9 MILLION

Number of iPads sold worldwide through September

None of the sellers contacted by *Bloomberg Businessweek* would give their full names or specify where they get their iPads. Yahoo! Auctions seller Richard, who is offering a free 16 gigabyte iPad to purchasers of a $704 camera connection kit that goes for less than one-twentieth the price in the U.S., says his supply came as gifts from friends overseas. Another seller on Yahoo! Auctions named Chen ($1,038 case, 64 gigabyte Wi-Fi-only iPad) isn't saying anything at all. "Reporters, don't ask me about the iPad," reads the large bold type on his Yahoo! Auctions profile. "I am not selling iPads, I am selling iPad cases. And my cases are more high-class."
—*Tim Culpan*

The bottom line *iPad sales are illegal in Taiwan until Apple's license is approved—so gray marketeers are giving them away with marked-up accessories.*

Innovator

Ronald Blum



The optometrist says his electronic eyeglasses improve on bifocals and progressive lenses, which cause nausea and headaches for some wearers

Many people over 40 can't focus on close-up objects, a condition called annoying—or, to be technical, presbyopia. Bifocals and progressive lenses provide a solution, since they contain prescriptions for both long-range and reading distances, but some patients have trouble adjusting to them and experience side effects like headaches or nausea.

That unsatisfying solution inspired Ronald Blum, founder and chief executive of PixelOptics in Roanoke, Va., to develop the world's first commercially available electronic eyeglasses. The frames look ordinary, but the arms hide a rechargeable battery, a microchip, and an accelerometer. When a wearer tilts his head down to view an object up close, the accelerometer detects the motion. The microchip sends an electronic signal to the lenses, part of which contains a substance similar to that used in liquid-crystal displays. The current from the battery alters how the liquid crystals refract light, changing the prescription of the lens. Because the wearer doesn't constantly deal with two prescriptions at once, PixelOptics lenses do away with the side effects, says Blum.

The eyeglasses will initially cost about $1,000, says Blum, 63, a 20 percent to 25 percent premium over high-end frames with progressive lenses. Still, he says, 50 million pairs of progressive lenses are sold each year, and if PixelOptics can grab just one or two percent of the market, "that's $200 million worth of business." The frames will go on sale in the U.S. early next year and globally by the end of 2011. Thomas Steinemann, an eye doctor in Cleveland and spokesman for the American Academy of Ophthalmology, says he may recommend the glasses to the more than 15 percent of his patients who can't adapt to progressive lenses or bifocals.

Electronic eyewear isn't Blum's first invention. He practiced optometry for more than 20 years before developing a cheap way to make lenses out of resin. He began by using tanning beds at a local salon to melt the resin. That tinkering led him to launch Innotech, a lens manufacturer that was acquired by Johnson & Johnson for $135 million in 1997. At J&J, he helped develop Definity, a popular progressive lens, before leaving in 1999 to work on the project that became electronic eyeglasses. He has no qualms about displacing his prior invention. "People put up with them because there's nothing better," he says. —*Olga Kharif*

Early Lab ▶ Fine-tuned his first invention under the lamps of a tanning salon

Insight ▶ Liquid crystals allow lenses to rapidly switch prescription

Potential ▶ A fraction of the market could be "$200 million worth of business"

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Technology should work to solve major problems in society.
So far, only 17% of senior executives think so. Join the debate at businessweek.com
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GOOGLE EARTH

The Faulty-Foreclosure Crisis Could Last for Years

▶ Questions about how documents were handled will generate lawsuits and investigations

▶ "This is going to become a hydra.... You don't even know the parameters of this yet"

The dimensions of the foreclosure crisis keep expanding. Lenders and loan servicers including **JPMorgan Chase** and **Ally Financial** are facing an explosion in homeowner lawsuits and state attorney general investigations of claims of falsified mortgage documents. Lawmakers in both houses of Congress have called for investigations. And procedural mistakes in the handling of mortgage documents have clouded titles establishing ownership of the homes, a problem that could plague both buyers and sellers for years. "This is going to become a hydra," says Peter J. Henning, a professor at Wayne State University Law School in Detroit. "You've got so many potential avenues of liability. You don't even know the parameters of this yet."

JPMorgan and Ally's **GMAC Mortgage** unit have delayed foreclosures in 23 states where courts have jurisdiction over home seizures. **Bank of America** suspended foreclosures as well, pending a review of documents. In December 2009, a GMAC employee said in a deposition that his team of 13 people signed about 10,000 documents a month without verifying their accuracy. "My suspicion is that this will wind up being an industrywide issue," says Patrick Madigan, Iowa assistant attorney general. "Many companies were using robo-signers."

Homeowners in class actions and individual lawsuits across the U.S. claim lenders and servicers have used falsified documents to foreclose on homes, sometimes when the banks didn't hold titles to the properties. Attorneys general in at least seven states are investigating foreclosure practices, and the number of these probes may grow. "You're going to see a tremendous amount of activity with all the AGs in the U.S.," says Ohio Attorney General Richard Cordray, who has sued Ally over foreclosures. "We have a high degree of skepticism that the corners that were cut are truly legal."

"We don't believe the procedural errors in these affidavits led to inappropriate foreclosures," Gina Proia, a spokeswoman for Ally, says. "We believe the accuracy of the factual

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Big breezes: Brazil's energy blessing page 56 ▶

loan information contained in the affidavits was not affected by whether or not the signer had personal knowledge of the precise details," JPMorgan says in a statement.

For lenders and loan servicers, civil lawsuits claiming deceptive sales practices or violations of consumer protection laws may be more troubling than claims brought by homeowners, says Christopher L. Peterson, a law professor at the University of Utah in Salt Lake City. Homeowners who were in default and lost their homes may not be able to prove losses, despite faulty documentation. "The attorneys general can just sue over deceptive sales practices and get penalties," he says.

The Mortgage Electronic Registration Systems is facing its own legal challenges. MERS, based in Reston, Va., was created by the mortgage banking industry to handle mortgage transfers between member banks. A lawsuit filed on Sept. 28 in federal court in Louisville on behalf of all Kentucky homeowners claims that MERS was part of a conspiracy to create false promissory notes, affidavits, and mortgage assignments to be used in mortgage foreclosures. Similar class actions have been filed on behalf of homeowners in Florida and New York. Karmela Lejarde, a MERS spokeswoman, declined to comment on any pending litigation.

88.8

BILLION DOLLARS

The value of stock companies issued in the U.S. in the first three quarters of the year, down 23 percent from the same period last year.

DATA: BLOOMBERG

Title insurers will also be in court bringing and defending lawsuits, says Henning: "They'll be on the hook if foreclosures are reopened. The title insurers will be going after the banks or whoever assured them there was a clear title." The costs for title insurers to defend customers and reimburse for lost properties rose 14 percent, to $480.5 million, in 2010's first half from the previous year, according to American Land Title Assn., a Washington-based industry group. "Questionable foreclosures will ultimately have little adverse impact" on new owners of properties or title insurance claims, the association said in an Oct. 1 press release.

People who bought homes in foreclosure face their own worries, as paperwork errors raise questions about the validity of the titles needed to prove ownership. "Defective documentation has created millions of blighted titles that will plague the nation for the next decade," says Richard Kessler, an attorney in Sarasota, Fla., who conducted a study that found errors in about three-fourths of court filings related to home repossessions.

A defective title means the person who paid for and moved into a house may not be the legal owner. "This is the most important issue of the whole mortgage mess," says Glenn Russell, a Fall River (Mass.) real estate attorney who won a case last year that reversed a foreclosure because of faulty paperwork. "Families are being thrown out of their homes by people who may not have the right to do that."

Almost one-fourth of U.S. home sales in the second quarter involved properties in some stage of mortgage distress, according to data firm RealtyTrac. Ownership questions may not arise until a home is under contract and the potential purchaser applies for title insurance or even decades later as one deed researcher catches errors overlooked by another. "It's a nightmare scenario," says John Vogel, a professor at the Tuck School of Business at Dartmouth College in Hanover, N.H. "There are lots of land mines related to title issues that may come to light long after we think we've solved the housing problem." *—Margaret Cronin Fisk and Kathleen M. Howley*

The bottom line *Faulty foreclosures will lead to a flood of lawsuits that may haunt lenders, title insurers, and home buyers for years to come.*

Banks

An Irish Tycoon and the Long Arm of Dublin

▶ A developer takes an Irish bank-workout agency to court

▶ "The Irish people are entitled to be angry with the bankers"

When Dublin property investor Patrick McKillen bought a 21-story Boston office tower for $170 million in 2006, his lender, **Anglo Irish Bank**, helped find an anchor tenant: itself. Such were the mutually beneficial business ties that once bound McKillen, a Belfast-born developer with a taste for trophy properties, and an Irish bank that made a colossal bet on the U.S. real estate market, where it expanded its lending sevenfold from 2004 to 2008.

$69 BILLION

What a bank bailout may end up costing the Irish government

Not a wise move for Anglo Irish, as it turned out, given the U.S. real estate bust. Anglo Irish was seized by the Irish government last year. As for McKillen, he's now entangled in a legal case with Prime Minister Brian Cowen's government that kicked off in a Dublin courtroom on Oct. 5. It's a case worth watching for global investors with a stake in the travails of Ireland's collapsed banking system, which may require as much as €50 billion ($69 billion) to clean up.

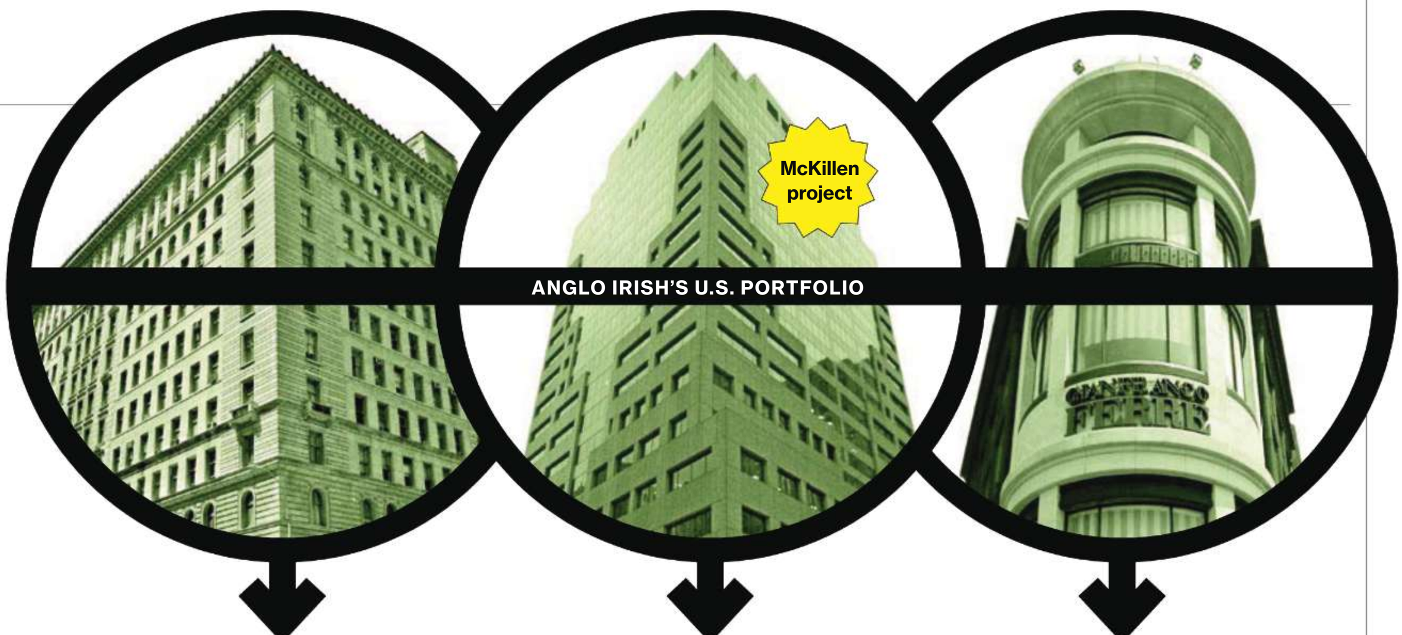
McKillen's lawsuit is challenging a decision by Ireland's National Asset Management Agency (NAMA) to take over €80 million of loans he has with the **Bank of Ireland**. NAMA was set up by the government last year to buy toxic assets from five major Irish lenders, including Anglo Irish. A lot is at stake for McKillen, who is co-owner of Dublin's Clarence Hotel with Irish rock stars the Edge and Bono of U2. The tycoon has exposure to €2.1 billion in property loans secured by his assets at home and abroad from various Irish lenders.

The Irish government has no right to take control of McKillen's real estate loans because they are performing and

FROM LEFT: WOBBEN WINDPOWER/ENERCON; LORENZO CINIGLIO/POLARIS; PHOTOGRAPH BY KELVIN MA FOR BLOOMBERG BUSINESSWEEK; FACE TO FACE/ZUMA PRESS

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The Apthorp, New York | **Anglo Irish Bank Headquarters, Boston** | **Two Rodeo, Beverly Hills**

would cause "significant adverse effects" to the business interests and reputation of McKillen, his lawyer, Michael Cush, argued in court. Cush said the properties backing the loans made to McKillen from Irish banks are generating €150 million in revenues annually, equal to 1.7 times interest payment costs.

Government lawyers haven't presented their arguments yet. NAMA announced plans this summer to acquire both nonperforming and income-producing loans as part of its drive to reduce the Irish banking system's exposure to commercial real estate. However, NAMA Chief Executive Officer Brendan McDonagh in an affidavit filed with the Dublin commercial court said debtors "who continue to meet their contractual obligations are fully protected" even if the loan is transferred to an agency.

Cowen's unpopular government faces enormous public pressure to lower the cost of the bank bailout. Selling off healthier loans, along with the duds, would help NAMA meet its stated goal of generating a profit of €1 billion over a 10-year period from the loan portfolio it acquires from Irish banks.

McKillen's suit against NAMA adds to the financial chaos surrounding the nation's banking system. The government on Sept. 30 said it might have to take majority control of **Allied Irish Bank** if the bank can't raise capital privately. "The Irish people are entitled to be angry with the bankers, who lent recklessly," Finance Minister Brian Lenihan told reporters in Dublin that same day.

McKillen is sparing no expense in his legal challenge. The developer enlisted Joseph Stiglitz, 67, the Nobel prize-winning professor of economics at Columbia University and former chief economist at the World Bank, as an expert witness. Stiglitz, who has filed an affidavit in the case with the Irish High Court, criticized Ireland's decision to set up NAMA, because "such value-destroying loan transfers hurt the banks, the economy and, most relevant to this case, good borrowers such as McKillen."

If McKillen succeeds in keeping his loans out of NAMA, others may follow suit. The outcome of the case could also have implications for the U.S. real estate market. Some of the $14 billion in Anglo Irish loans that NAMA could conceivably pick up are tied to prestige properties, including a Rodeo Drive shopping mall in Beverly Hills, Calif., and the century-old Apthorp apartment building on New York's Upper West Side. "Big real estate players have tried to pursue purchasing Anglo Irish's assets but have been tripped up by uncertainty around who is actually in control: the bank or NAMA," says Ben Thypin, an analyst at Real Capital Analytics in New York. Private equity firms including **Blackstone Group** and **Colony Capital** have discussed buying Anglo Irish's U.S. loans, say two people with direct knowledge of the talks.

In McKillen, Anglo Irish had a client with U.S. ambitions of his own. In 2006 he bought three Boston properties with about $200 million of Anglo Irish loans through his flagship **Clarendon Properties (Holdings)**, of which he owns 50 percent. The acquisitions included Anglo Irish's Boston headquarters on Franklin Street. At the end of June 2008, U.S. properties returned more than €16 million of rent to McKillen's company, according to Irish corporate filings. The U.S. properties are "95 percent" rented and the loans are "fully performing and fully compliant," says McKillen's spokeswoman, Breda Keena. *—Donal Griffin, Jonathan Keehner, and Joe Brennan*

The bottom line *A legal tangle between an Irish developer and the government could delay the country's banking-crisis cleanup.*

Insurance

Prudential and AIA Fight It Out in Asia

▶ CEOs Thiam and Tucker both want to grow in the region

▶ "It's a case of eat or be eaten," says one money manager

Prudential's Tidjane Thiam tried and failed to buy **AIA Group** to expand in Asia, his first test as chief executive officer. To succeed now he will have to beat AIA's new CEO—and his ex-boss—Mark Tucker. Thiam's former mentor has begun gauging investor appetite for an initial public offering of AIA, which at about $15 billion would

be one of Hong Kong's largest. The IPO of AIA, a unit of **American International Group**, marks the beginning of a race that will pit Thiam, 48, and Tucker, 52, in a contest for the world's fastest-growing insurance market.

"It's a case of eat or be eaten," says Christopher Wong, a fund manager at Aberdeen Asset Management in Singapore, which oversees $267 billion of assets including Prudential shares. "The growing sophistication of Asian consumers in terms of wealth management and family protection is a direct benefit to life insurers in Asia. It's going to be a new battleground for growth."

For Thiam, success in Asia will help appease investors who called for him to quit after his £25.7 ($35.5 billion) bid for AIA collapsed. For Tucker, AIA's IPO will give him independence from AIG. Prudential (which is not related to New Jersey-based Prudential Financial) and AIA are the two biggest international insurers in Asia and the only two with branches across the continent. "We've been competing for a long time," Thiam told Bloomberg in an August interview. "It's well recognized they are in need of a turnaround. We've taken them over in growth, profitability, and in margins. That momentum is real." Thiam declined to give a forecast for sales growth in Asia, which provided 44 percent of the company's profit from new business in 2009, saying that expansion depends on factors he can't control such as economic growth. "We will do better than the competition," he says. "That we can control." Failing to beat AIA may "be the catalyst for a takeover" of Prudential, says Jonathan Newman, an analyst at Brewin Dolphin Holdings, which manages £21.6 billion including Prudential shares.



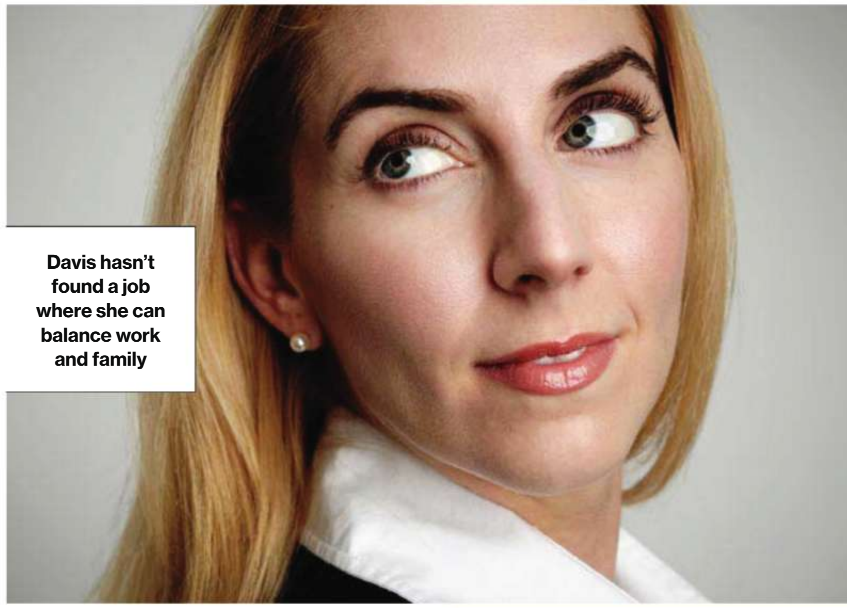
Tucker (left) once hired Thiam. Now the men run rival companies

While Prudential has accelerated sales in the region since 2008, AIA has been hurt by the U.S. bailout of AIG. Its sales declined 5 percent, to $11.6 billion, in 2009 as AIG's rescue deterred potential customers. "Prudential's agents in Asia are currently much more productive than AIA's, but I expect AIA to narrow the gap pretty quickly," says Martin Brown, who helps manage £69 billion at **Ignis Asset Management**, one of Prudential's 30 biggest shareholders. Prudential had about 410,000 sales agents in Asia at the end of 2009 compared with about 320,000 at AIA. Both companies compete in Asia with **China Life Insurance**, **Ping An Insurance**, and **Axa Asia Pacific Holdings**.

In 2008, when Tucker was serving as CEO of Prudential, he plucked Thiam from rival U.K. insurer **Aviva**, giving the Ivory Coast-born French national his first job on the board of a publicly traded company. British-born Tucker, who was a professional soccer player in his youth, left Prudential in 2009, handing the top job to his protégé. In July, AIG CEO Robert H. Benmosche picked Tucker to head AIA.

Tucker plans to sell about 49 percent of the company this month, according to two people with knowledge of the matter. The proceeds will go toward paying back the U.S. government. Tucker and Patricia Chua, a Hong Kong-based spokeswoman for AIA, declined to comment. The IPO would give Tucker a platform to make a takeover bid for Prudential, says Barrie Cornes, a London-based analyst at Panmure Gordon. That possibility does not worry Thiam. "I love Mark and respect him," he said in August. "We can't become obsessed with AIA. We don't see it as a threat." —*Kevin Crowley*

***The bottom line** Having failed to buy his chief competitor in Asia, Thiam is now going up against his old boss in one of the world's richest markets.*



Davis hasn't found a job where she can balance work and family

Compensation

Women on Wall Street Fall Further Behind

▶ The pay gap—the biggest of any industry—has gotten wider

▶ "Women are fighting the same old battles... higher up the chain"

Nancy Davis, a rising star at **Goldman Sachs,** left in January 2008 after an eight-year run betting the firm's money on derivatives to become a portfolio manager at **Highbridge Capital Management**. She lost that job 10 months later when the hedge fund cut back in the recession.

For women in the financial-services industry such as Davis, who's still unemployed, the last few years haven't been kind. More than five times as many women as men lost their jobs in the three years after July 2007, and pay for full-time female managers compared with their male counterparts worsened between 2000 and 2007, according to U.S. government data.

It has been more than a decade since a case brought by Smith Barney brokerage employees served to dismantle Wall Street's mandatory arbitration rules. Merrill Lynch was confronted with sex-discrimination claims from 900 women, and Allison Schieffelin, a former bond saleswom-

FROM LEFT: C. BIBBY/FINANCIAL TIMES-REA/REDUX; SIMON DAWSON/BLOOMBERG; PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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58.8¢

Amount women managers in finance earned for every $1 men earned

an, filed a gender-bias suit against **Morgan Stanley**–a case later settled for $54 million. Yet not a lot has improved for women in banking.

Women managers in finance, which includes bank tellers and executives, have seen the pay disparity worsen in recent years. Based on median salaries, they suffer the largest pay gap of any industry, earning 58.8¢ for every dollar a man earned in 2007, the most recent year for which data is available, down from 63.9¢ in 2000, according to Government Accountability Office data analyzed by Bloomberg. "When you have an industry dominated by men like finance and compensation going through the roof, it's not surprising that it increases the gender disparity between men and women," says Joan C. Williams, a professor at the University of California's Hastings College of Law in San Francisco. "The sky's the limit for men who hit a home run, but women can't get to first base."

Last month, Goldman Sachs was sued by three former female employees who say they received less pay and fewer promotions than men at the firm. One of the women claimed she had been pinned against a wall and groped by a male colleague after a 1997 client meeting at Scores, a Manhattan topless bar. Ed Canaday, a Goldman Sachs spokesman, says the suit is "without merit."

Women have gained some ground over the last decade. Executives including Mary Erdoes, CEO of asset management at **JPMorgan Chase**, Lisa Carnoy, co-head of global capital markets at **Bank of America**, and Isabelle Ealet, global head of commodities at Goldman Sachs, have risen to positions of prominence at the biggest U.S. banks.

Davis, 33, says Goldman Sachs and Highbridge, which is owned by JPMorgan, bent "over backward to keep women." Goldman gave Davis a maternity "buddy," a senior female manager, to help her make the transition back to work after both of her pregnancies and placed her in its Leadership Acceleration Initiative, a program to promote development of high performers. "I never saw unfairness or discrimination," says Davis.

Still, for a trader with her credentials, finding the right job with the right work-life balance has been harder than she expected. Davis wants to see her four-year-old and seven-year-old before bed without being relegated to the "mommy track," she says, recalling a recent job interview she had with a small hedge fund: "I think they were concerned about my ability to work until 2 a.m. given my family commitments. They realized that, and I realized that. It wasn't the right fit."

Many Wall Street firms assign women to less prestigious trading desks and divisions with the smallest bonus pools, says Kelly Dermody, a partner at Lieff Cabraser Heimann & Bernstein, the law firm representing the women suing Goldman Sachs. "Women are fighting the same old battles, just in a new environment higher up the chain," she says. One of the complaints in the Goldman Sachs case is that the proportion of female managers shrinks at higher levels. Women constituted 29 percent of the firm's vice-presidents, 17 percent of its managing directors, and 14 percent of its partners in 2009, the complaint says. JPMorgan has three women on its 16-person operating committee. Morgan Stanley has just one woman among its top dozen executives. **Citigroup** doesn't have any women on its 19-member executive committee. Shannon Bell, a spokeswoman for Citigroup, said women run many businesses and important functions, including the firm's private bank, personal banking, and wealth management. Darin Oduyoye, a spokesman for JPMorgan, and Mark Lake, a spokesman for Morgan Stanley, declined to comment.

"In the old days the problem was conscious, explicit discrimination," says Susan Estrich, a professor of gender-discrimination law at the University of Southern California in Los Angeles. Today, it's different, she says. "People who are doing the judging unconsciously prefer people they're comfortable with, people they know, people who look like them, people whose experience they recognize." —*Dawn Kopecki*

The bottom line *While some conditions have improved, women in finance are earning a smaller percentage of men's pay than they did in 2000.*

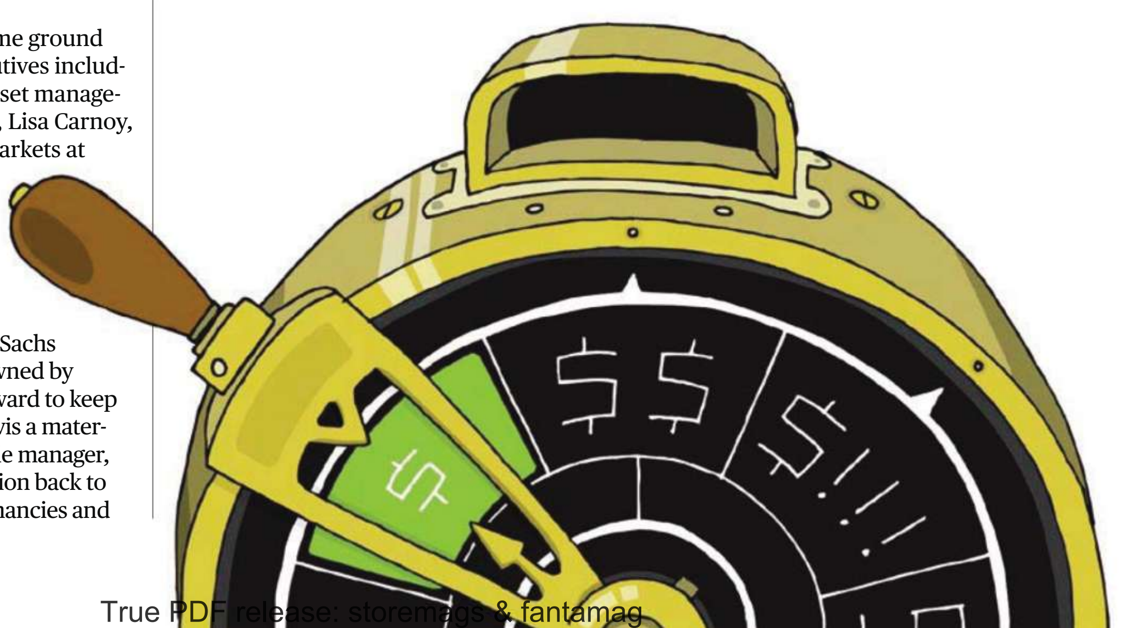
Earnings Outlook

The Corporate Profit Engine May Be Slowing

▶ Analysts cut their forecasts for the first time since June 2009

▶ "You need pretty fancy GDP numbers to get to $95 a share"

For the first time in more than a year, Wall Street analysts cut their forecasts for Standard & Poor's 500-stock index earnings during the course of a quarter, casting a shadow over the stock market outlook. Analysts reduced their estimates for S&P 500 companies'



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combined 2011 profit to $95.21 a share as of Sept. 30, down from an August high of $96.16 and $95.50 on June 30, according to more than 8,500 forecasts tracked by Bloomberg. The last time analysts' earnings estimates fell during a quarter was in the three months ended June 2009. The figure has since rebounded to $95.97 a share.

Even the lower level would represent a rise of 14 percent from 2010 and a record for U.S. corporate profits. Some Wall Street professionals think the reduced estimates are overly optimistic. "You need pretty fancy GDP numbers to get to $95 a share in earnings next year," says Robert Doll, vice-chairman of New York-based BlackRock, which oversees $3.2 trillion. "Our view is that they're still a little too high, and that nobody believes them."

A slowdown may show up as companies report results for July through September. Analysts expect companies in the S&P 500 to report profit increases of 23 percent on average for the third quarter, according to forecasts tracked by Bloomberg. That would be about half the 49 percent growth during the second quarter and the 52 percent increase from January through March.

The reduction in earnings expectations—which came as the S&P 500 index rose 8.8 percent last month, the largest September advance since 1939—may presage lower stock prices. "If analysts are lowering estimates on a broad basis, the market should reflect that," says Wasif Latif, vice-president of equity investments at USAA in San Antonio, which oversees $45 billion.

Yet some money managers are not concerned. Michael Levine, who helps oversee $165 billion at OppenheimerFunds, says the outlook for lower earnings is already reflected in stock prices. Based on the most recent forecasts, the S&P 500 is valued at 12 times estimated income for 2011, according to data compiled by Bloomberg. "Equities are cheap," says Levine. Investors "are assuming there's a slow but gradual recovery," he adds. "As long as that's the message, the markets will be fine."
—Lynn Thomasson, Whitney Kisling, and Inyoung Hwang

The bottom line *Wall Street forecasters have knocked down their forecasts for corporate profits for the first time in more than a year.*



Whitney has made wrong calls on Visa and Capital One Financial

Wall Street

Meredith Whitney Is a Mere Mortal After All

- **Many of her calls on financial stocks have been mistaken**
- **Her opinion is valuable, "but she does not bat 1,000—nobody does"**

Meredith A. Whitney, the bank analyst who jumped from obscurity to celebrity by correctly predicting that deteriorating finances would force **Citigroup** to cut its dividend in 2007, is having less success divining stock market winners and losers. Since Whitney founded her own firm last year, about two-thirds of her picks have fared worse than market indexes. Missed calls include **Visa**, the payments network that fell 14 percent from May 4, when Whitney named it her "single best buy," through Oct. 5, and credit-card issuer **Capital One Financial**, which tripled after she urged clients to sell.

Whitney's recommendations to sell bank stocks propelled her to fame during the financial crisis. *Time* magazine dubbed her one of the world's most influential people, *Fortune* put her on its list of the 50 Most Powerful Women in Business, and Michael Lewis's bestseller, *The Big Short*, chronicled her role in the financial crisis.

"She can move the markets. Her opinion is extremely worthwhile, but she does not bat 1,000—nobody does," says Matthew D. McCormick, a portfolio manager at Cincinnati-based **Bahl & Gaynor**, which oversees $2.7 billion. Whitney, 40, who left **Oppenheimer** in February 2009 to found **Meredith Whitney Advisory Group**, didn't respond to requests for comment.

Bank analysts struggled to pick winners and losers after the credit crisis forced Wall Street to reevaluate risk, unwind government bailouts, and adjust to the biggest regulatory overhaul since the 1930s. Even top Wall Street firms and individual stock pickers failed to predict the fall and rise of most financial stocks, according to rankings in the November 2010 issue of *Bloomberg Markets* magazine. **Goldman Sachs** won the No. 1 rank by making 30 accurate calls on the 79 financial stocks its analysts follow. **KBW** analysts, including Sanjay Sakhrani, ranked second. Whitney's firm wasn't ranked in the top 20.

Whitney made six accurate and 13 inaccurate picks through Sept. 30, based on annualized returns including dividends on her 19 recommendations, when compared with the performance of the S&P 500-stock index. She was right seven times and wrong 12 when compared with the

Quoted

"Almost all the growth we had in the third quarter" was the result of auto production. "The fourth quarter could actually be flat to negative."
—David Rosenberg, chief economist, Gluskin Sheff + Associates



FROM LEFT: ILLUSTRATION BY ALEX EBEN MEYER; ROBYN TWOMEY/CORBIS OUTLINE; BLOOMBERG

81-company S&P 500 Financials Index. Correct predictions are stocks rated "buy" that outperformed the indexes or a "sell" that underperformed. A rating of "hold" or "neutral" is right if the stock underperformed or matched the indexes, unless it was upgraded.

Whitney's first stock call as her own boss came on Mar. 4, 2009, when she rated Goldman Sachs "neutral," which investors may interpret as a signal to sell. The stock surged 75 percent in about four months. Other misses came on Apr. 1, 2009, about a month after stocks had begun to rebound, with a wrong-way "sell" call on McLean (Va.)-based Capital One and a "neutral" rating for **American Express**. Capital One more than tripled through June 14 of this year. After a Whitney upgrade to "hold," it underperformed the index by 26 points. New York-based AmEx, the biggest credit-card issuer by purchases, almost tripled and was last year's top performer in the Dow Jones industrial average.

Whitney's correct calls include "neutral" or "hold" ratings on **Morgan Stanley**, **JPMorgan Chase**, **U.S. Bancorp**, and Pittsburgh-based **PNC Financial Services Group**. Morgan Stanley has returned 3.5 percent on an annualized basis and JPMorgan 23 percent since she started coverage on the stocks on Apr. 1, 2009, vs. 28 percent for the S&P 500.

Other analysts have found mainstream celebrity fleeting. Abby Joseph Cohen, senior investment strategist at Goldman Sachs, made her reputation with a bullish view of the stock market before the S&P 500 sank for three straight years beginning in 2000. Morgan Stanley's Mary Meeker, dubbed the "Queen of the Net" by *Barron's* magazine in 1998, receded from the spotlight after Internet stocks imploded.

Institutional investors don't value analysts solely for the stock picks, McCormick says: "What they want is consistency, logic" in their evaluations of companies. And Whitney's fortunes could improve. "The calls that she's making may not be the best calls right now," says McCormick. "But a year from now, who knows?"
—*Peter Eichenbaum*

The bottom line *After making her name on the strength of one great call, Whitney has compiled a mixed record, at best, as a stock picker.*

Bid & Ask

by Cristina Lindblad



1 **Sanofi-Aventis** launched an $18.5 billion hostile takeover of Genzyme after management at the U.S. biotech firm spurned its bid as too low. Genzyme is telling shareholders to sit tight.

2 **Emirates Telecommunications** offered $10.5 billion for 46 percent of mobile carrier Zain, which operates in Kuwait, where it is based, as well as Iraq and Bahrain.

3 **American International Group** agreed to sell two Japanese life insurers to Prudential Financial for $4.8 billion. AIG is shedding assets to repay a $182 billion government bailout.

4 **General Electric** acquired Dresser, a Texas-based maker of equipment for oil and gas exploration, for $3 billion.

5 Mexico's **Grupo Televisa** is paying $1.2 billion for as much as 35 percent of television broadcaster Univision Communications in a bid to expand its Hispanic audience in the U.S.

6 Seeking to take advantage of global investor demand for higher-yielding paper, **Mexico** sold $1 billion in 100-year bonds, the longest-maturity debt ever issued by a Latin American country.

7 Mortimer Zuckerman is adding another trophy building to his collection. Zuckerman's **Boston Properties** is paying $930 million for New England's tallest building, the 62-story John Hancock Tower in Boston.

8 Buyout firm **Blackstone** has acquired Polymer Group, a maker of materials used in disposable diapers and surgical gowns, in a deal valued at $602 million.

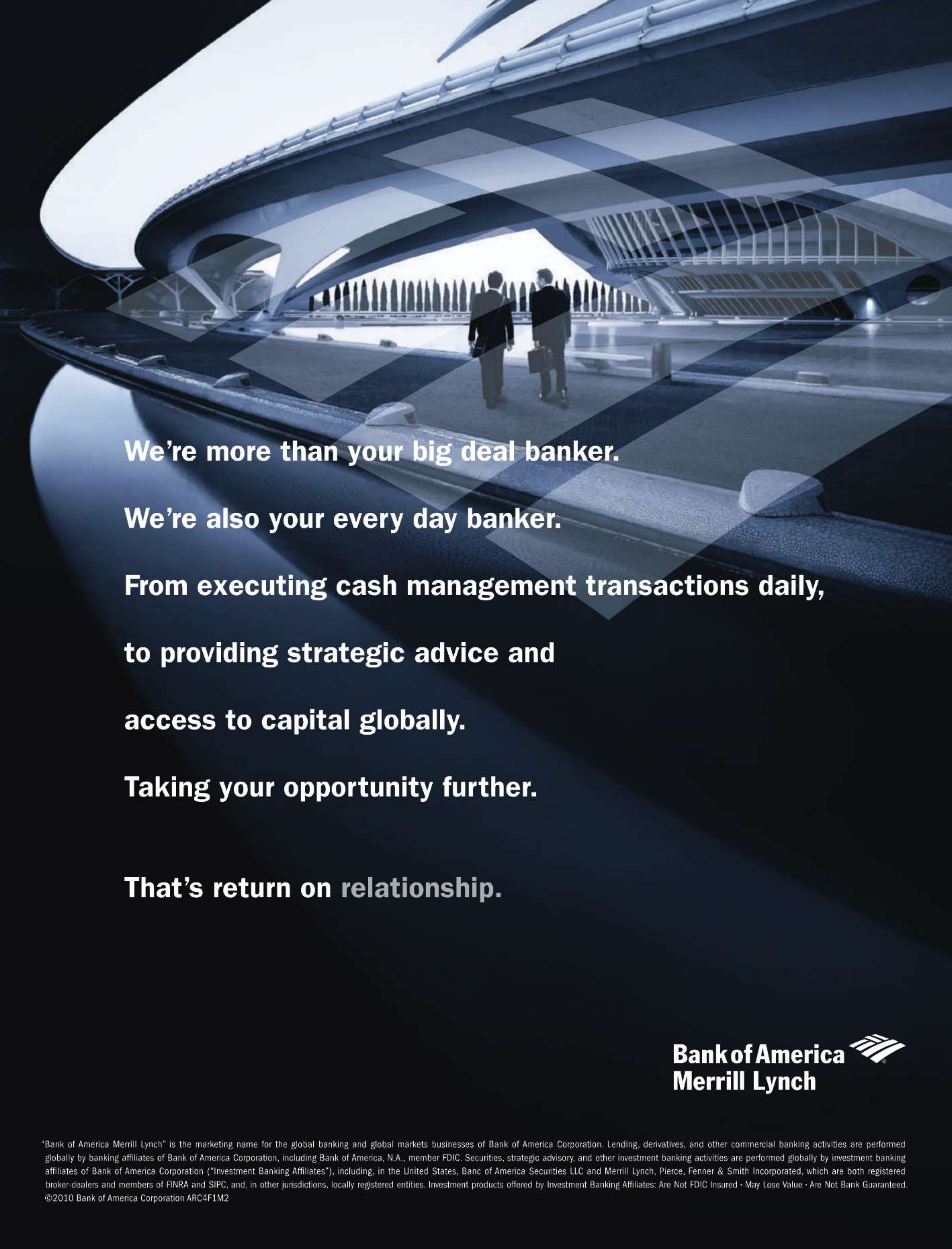
9 **Henry Kravis,** the billionaire co-founder of private equity firm KKR, pledged $100 million to Columbia Business School, where he earned his MBA.

10 A 1992 painting of a baby by **Zhang Xiaogang** fetched $6.7 million at a Sotheby's auction in Hong Kong, setting a record for the Chinese artist.

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Contents ▶ Bringing GE experience to Abound Solar 54 ▶ Brazil's ambitious wind power plans 56 ▶ How better weather forecasts lead to cleaner energy 58 ▶ Speed Dial: Shell Oil's Marvin Odum 59 ▶ Commentary: The perils of protectionism 60 ● Edited by Cristina Lindblad

Focus On **Alternative Energy**

Green Startups: Trapped In the 'Valley of Death'

▶ **Young cleantech companies are running out of gas on the road to going public**

▶ **"When it comes time to write that $500 million to $1 billion check, nobody's home"**

Startup companies call it the Valley of Death—the arduous terrain between proof of concept and the beginning of mass production and significant sales. In good times, just 40 percent of companies go public or get acquired, according to John Taylor, head of research at the National Venture Capital Assn. in Arlington, Va.

Now the Valley is even deadlier. Hundreds of U.S. cleantech startups find themselves stuck on the road to serious revenues because of the toxic combination of a stalled economy, scarce funding, and Washington's failure to enact comprehensive climate and energy legislation. The market for initial public offerings is frozen and venture capital is drying up because of uncertainty. Faysal Sohail, a managing director at **CMEA Capital**, a San Francisco fund that helps oversee $1.2 billion in venture capital investments, says that at the start of the year he had six profitable companies that were ready to go public but couldn't. "It's a sour mood," he adds.

Venture capital and private equity firms have poured some $49.3 billion into solar, wind, and other alternative energy companies since early 2000, according to data compiled by Bloomberg New Energy Finance (BNEF), a research unit. Most placed their bets with the expectation that they would cash out in five to seven years. In the new normal, that horizon is getting pushed out. "We're about 12 to 18 months behind where we expected to be," says Alan Salzman, founder and chief executive officer of **VantagePoint** ➜

While Tesla made a splash with its IPO, only two other U.S. cleantech companies have gone public this year

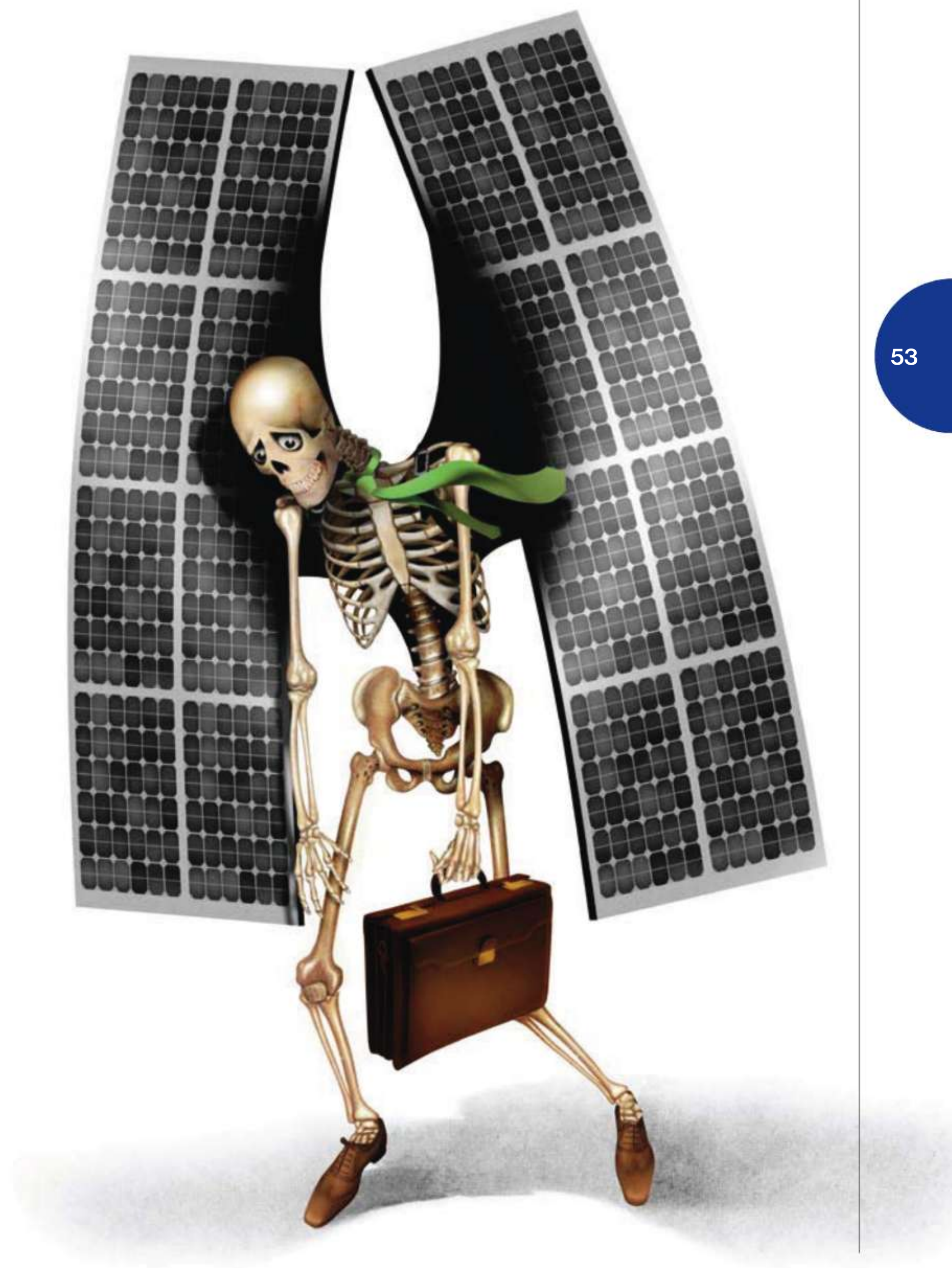


ILLUSTRATION BY BRETT RYDER

Alternative Energy

Venture Partners, which has channeled more than $5 billion into startups, including **BrightSource Energy** and **MiaSolé**, two solar ventures.

The same complaint is being heard across the VC community. "We're in a difficult market for initial public offerings, cleantech or otherwise," says Brian Bolster, head of alternative energy investment banking at **Goldman Sachs** in New York. "There are 108 IPOs that are stale–or at least 100 days old," he says, referring to the number of days since companies filed paperwork to go public. "We're seeing companies come out, but it's about a tenth of those that want to come out."

While **Tesla Motors** made a splash with its June IPO, raising $226 million, only two other U.S. cleantech startups have staged offerings this year: biofuel companies **Codexis** and **Amyris**. Tesla now trades 23 percent above the IPO price of $17. Codexis is down 15 percent since trading started on Apr. 21, and in September, Amyris managed to raise just $84.4 million at below its intended price range, according to BNEF.

Wall Street's interest in these companies has been fueled in part by the Obama Administration's $787 billion stimulus package, which makes new transportation technologies a priority. Solar panel makers haven't received a similar boost because of the Administration's failure to win support for a federal renewable energy mandate and a cap on carbon dioxide emissions, both of which would boost demand for clean power.

For startups that cannot go public, the next best option is finding deep-pocketed partners willing to pony up millions for new factories and equipment. Such partners are hard to find. And when marriages can be arranged, they take place at an earlier stage, notes Sohail. "It used to be we'd wait for round D to find a partner. Now it's right away."

France's **Areva** in February bought **Ausra**, a California company developing solar thermal power plants, for an undisclosed sum. Last month, Japan's **Sharp** paid $305 million for **Recurrent Energy**, a U.S. developer of rooftop solar arrays, in a bid to win back market share being taken by Chinese panel makers. "It's a capital-intensive business and we reached the limits of private equity," says Arno Harris, Recurrent's CEO. "With Sharp's balance sheet, we'll have no problem."

Many an entrepreneur right now wishes he were in Harris' shoes. An Oct. 1 report from Cleantech Group, a San Francisco research outfit, noted that VC investments in clean technology fell 30 percent in the third quarter, to $1.53 billion, compared with the same period last year, with solar taking the biggest hit. "Venture capital has been very good at driving technology," says Goldman's Bolster. But even VCs don't have pockets deep enough to pay for scaling up these capital-intensive businesses. "When it comes time to write that $500 million to $1 billion check," Bolster says, "nobody's home."
—*Christopher Martin*

The bottom line *In a market that is less receptive to initial public offerings, more cleantech startups are willing to be acquired in order to survive.*

Quoted

"It's been a long time since we've had them up there."
—U.S. Energy Secretary Steven Chu, referring to the Administration's decision to install solar panels on the White House roof, 24 years after Ronald Reagan had them removed





Tiller plans to add 1,200 jobs in the U.S. over the next three years

Solar

Bringing Good Things to Sunlight

▶ Abound Solar is counting on a GE veteran to streamline production

▶ "As we build to scale, our simpler process will give us the advantage"

Less than a year after retiring as chief executive officer of snowmobile maker **Polaris Industries**, Tom Tiller was approached by a solar startup about its top job. Tiller, 49, was torn. He'd intended to dabble in nonprofits and teach at his alma mater, Massachusetts Institute of Technology. Then, as he was mulling the offer last November, a large crate arrived at his Minnesota home. Inside was a black solar panel with a message etched on its surface: "With your leadership we can change the way the world is powered." It was signed by the board and founding members of **Abound Solar** in Loveland, Colo. "I was truly touched," recalls Tiller. "It helped me explain to my family and friends why I even considered packing up and moving to Colorado to become a CEO again."

Most solar panels convert sunlight into electricity using silicon-based photovoltaic cells. Abound Solar, formerly known as AVA Solar, uses a less costly cadmium-telluride thin-film process developed by W. S. Sampath,

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Alternative Energy

one of its founders, while teaching at Colorado State University. Thin-film panels make up about 15 percent of the $28 billion global solar-panel market and have been gaining fast as prices for crystalline silicon have spiked in recent years. Tom Blaisdell, a partner at **DCM**, a Silicon Valley venture capital firm that led a $100 million investment in Abound in 2008, calls Abound's manufacturing process "deceptively simple." Says Blaidsell: "Glass goes in one end and comes out the other as a giant semiconductor."

In July, Abound won a $400 million loan guarantee from the U.S. Energy Dept., part of which will be used to double annual panel production at its year-old Colorado plant to the equivalent of 200 megawatts—enough to power about 50,000 homes. The rest of the money will be used to complete a larger factory in Tipton, Ind. The privately held company employs 450 workers and plans to hire an additional 1,200 over the next three years.

Tiller spent 15 years at **General Electric** before decamping to Polaris Industries in 1998, where he more than tripled profits. He'll face plenty of competition in his new job. Globally, manufacturing capacity in solar panels is set to soar to 30,000 megawatts by 2013, from 10,104 megawatts last year, according to projections from Bloomberg New Energy Finance. The market leader is **First Solar**, based in Tempe, Ariz., with $2.1 billion a year in revenues and about a six-year head start on Abound in commercializing cadmium-telluride thin film. "Getting production lines to run smoothly has been difficult," says Jenny Chase, solar analyst at BNEF. "First Solar took 10 years to get it right."

First Solar has managed to drive down production costs enough to be able to undercut Chinese manufacturers of silicon panels, even with their lower labor and financing costs. Deep-pocketed players are now stepping into the market. GE in 2008 acquired a majority stake in **PrimeStar Solar**, another Colorado-based company that uses thin-film technology. "I'm intrigued by solar," said GE CEO Jeffrey Immelt at a Sept. 23 conference in Washington. "So we bought a solar technology company, put about $50 million into it, and now will scale it." First Solar would not comment.

Tiller, who holds an MBA from Harvard and an engineering degree from MIT, says his 15 years at GE learning to improve manufacturing processes will help Abound beat First Solar by streamlining panel-making. "Henry Ford transformed the auto industry with his assembly line," he says. "As we build to scale, our simpler process will give us the advantage." —*Christopher Martin*

***The bottom line** Years spent honing manufacturing techniques under Jack Welch will come in handy as Tom Tiller boosts output at Abound Solar.*

Wind Power

Brazil Wants to Put The Weather to Work

▶ A force in ethanol, the country is now ramping up its wind capacity

▶ "All the ingredients are here for Brazil to grow to a large market"

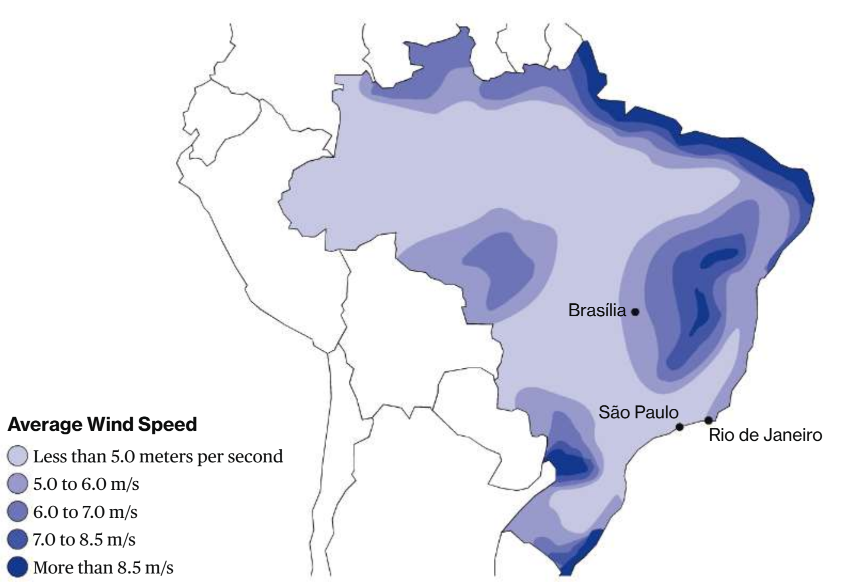
Brazil, the world's No. 2 producer of ethanol, hopes to become a power in another alternative energy field. The country intends to become Latin America's clean energy king by increasing fivefold its capacity to generate electricity from wind by 2013—harnessing the same trade winds that propelled European sailors to the Americas five centuries ago.

The easterly breezes in northern Brazil are among the most consistent weather patterns in the world, according to the American Meteorological Society. They allow for the deployment of cheaper, lighter turbines, instead of the more rugged ones designed for unexpected gusts. "Wind conditions are amazing in Brazil, far better than what is available in the U.S. and Europe," says Unai Otazua Aranguren, head of the engineering group at **GL Garrad Hassan**, a renewable energy consulting firm in the U.K.

Brazil has been slow to capitalize on its natural bounty. Wind accounts for just 0.7 percent of its 113 gigawatts of electricity generation, according to Brazil's power regulator, the Agência Nacional de Energia Elétrica (Aneel). The country derives 73 percent of its electricity from hydropower and sometimes suffers shortages during the dry season when reservoir levels fall.

To remedy that problem, the government has held auctions in recent years for rights to build wind farms. In the past 10 months, power companies have won contracts to build 3.9 gigawatts of new wind capacity, vs. 797 megawatts of total capacity now installed. Wind project developers such as **Iberdrola Renovables**, **Renova Energia**, and **Gestamp** have signed deals to supply turbines for 70 wind farms with a capacity of generating 2 gigawatts of power at an average cost of $74.4 per

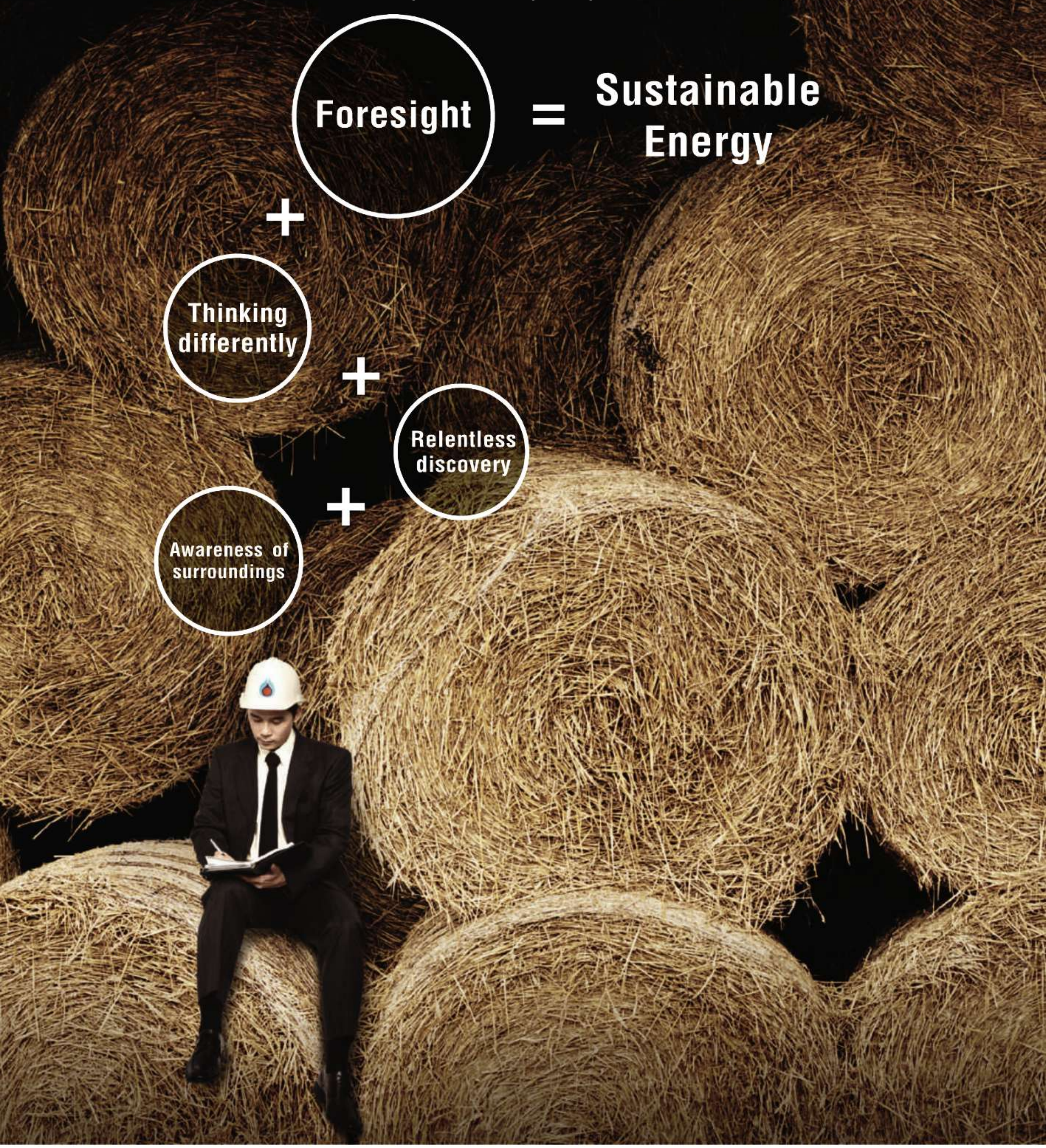
Brazil's Wind Map



DATA: BRAZILIAN WIND ENERGY CENTER

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After years of extensive R&D work, a breakthrough has been discovered in turning things around us into a source of sustainable energy. PTT has introduced this innovative technology which includes an advanced biochemical process that turns rice straw into ethanol fuel. Our quest for alternative energy sources is ongoing, and always will be, for the even better energy future of Thailand.

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megawatt-hour, low compared with projects in the U.S. and Europe.

Brazil's push into wind energy is well timed. Its currency, the real, has appreciated 35 percent against the dollar since the end of 2008. That cuts the costs of equipment made abroad by suppliers such as **Vestas Wind Systems** of Denmark, **Siemens** of Germany, and **General Electric** in the U.S. "All the ingredients are here for Brazil to grow to a large market very quickly," says Steve Sawyer, secretary general at the Global Wind Energy Council, a Brussels-based industry group.

Whether Brazil's wind power sector can be hugely profitable remains uncertain. Developers will have trouble making robust profits because they agreed to sell their electricity at ultra-low prices, on the expectation that their turbines will operate at their top capacity 46 percent of the time—almost double the rate in Europe. An analysis by Bloomberg New Energy Finance indicates that some of the bid-winning projects could have returns below 10 percent—two percentage points lower than some European wind farms manage.

Gustavo Silva, who heads the Brazil office of Portuguese energy consultant Megajoule, believes there's a possibility that some projects will not be rolled out. "Some developers have a lot to worry about," says Silva. "Projects will have to be technically well designed and leave little room for uncertainty." —*Stephan Nielsen*

The bottom line *Blessed with steady breezes, Brazil aims to expand its wind power capacity fivefold and be an alternative energy leader in Latin America.*

Forecasting

Predicting Where The Wind Will Blow

▶ Utilities worldwide are searching for better accuracy

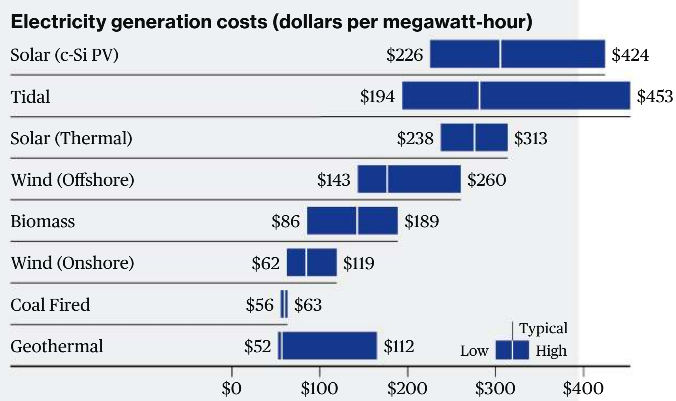
▶ "Better forecasts ... mean the potential for using less coal"

Xcel Energy is shutting down some of its coal-fired plants for hours or days—not because of environmental pressure or legislative changes that mandate it, but because it has a new tool to work with: accurate wind forecasts. The readings are part of a project that Minneapolis-based Xcel, the largest U.S. wind-power producer, is working on

Renewable Energy

The Economics of Alternative Energy

Electricity generated from fossil fuels is starting to lose its price edge over renewable energy sources. Some technologies, such as wind, are already competitive with coal and natural gas in some parts of the world. Other technologies have high up-front costs, so they are difficult to implement. Below, a look at which renewables are catching on.



Solar (c-Si PV)

The crystalline silicon solar-cell industry continues to mature as manufacturers grow larger and more sophisticated. As prices for solar cells drop, the technology is moving closer to being competitive in some major markets, such as Italy, even without government subsidies.

Tidal

One of the pluses of tidal energy is its predictability. Yet an inability to secure bank financing will likely keep tidal projects at the high end of the cost scale in the near term. Countries with a natural advantage, such as the U.K., will continue to invest in R&D and pilot projects.

Solar (Thermal)

The technology originated in the U.S. in the 1980s and has enjoyed a resurgence this decade. The current hotspot is Spain, while the U.S. will soon break ground on large-scale developments. One advantage: solar energy is collected as heat, so power can be generated outside daylight hours.

Wind

Wind is the most prevalent of the alternative technologies because of its relatively low cost, though offshore wind is still much more expensive than wind generated on land. The pace of development is down, as the recession has driven down electricity prices.

Biomass

This mature technology is widely used in many countries. Using waste products and agricultural residues as sources of fuel would make biomass competitive with other power-generation methods, but with dedicated fuel crops, the costs remain prohibitive.

Geothermal

While the potential is great, particularly in developing nations, geothermal technology has been constrained by high up-front costs and risks associated with drilling. Supportive policies in the U.S., Germany, Australia, Indonesia, and Kenya will provide a boost from 2012 onward.

DATA: BLOOMBERG NEW ENERGY FINANCE

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Diaper wars: This could get stinky page 62 ▶



with Colorado's National Center for Atmospheric Research. NCAR feeds data collected by satellites, aircraft, and weather stations into supercomputers to figure when Xcel can turn off coal-fired plants and substitute power from hundreds of wind turbines deployed across the foothills of the Rocky Mountains.

Fitting irregular streams of wind power generated by tens of thousands of turbines in the U.S., Europe, and China into electricity grids that need to keep supply and demand in close balance is a complex challenge for utilities. Using a constant energy source like coal is far easier. Power surges from wind must be balanced in the electrical grid and can make pricing volatile. "With better forecasts you will get better dispatching of power, and that means much greater efficiency for the whole system," says Olav Hohmeyer, an energy researcher at the University of Flensburg, Germany. "That means the potential for using much less coal and gas."

If more accurate readings lessen the $500 billion-plus spent on burning coal each year, utilities could benefit, since in many countries coal, one of the cheapest energy sources, is becoming or expected to become more costly. Wind power is almost as cheap–but unpredictable.

Because many nations and states, including Germany, Denmark, Spain, and Colorado, require the use of wind before turning to coal or gas for energy needs, utilities sometimes must cut output of fossil fuel plants to avoid overloading the electrical grid, which could lead to outages. Germany's **E.ON** and Denmark's **Dong Energy** are among utilities that have used wind forecasts with varying degrees of success. The government-provided forecasts that Spanish network operator **Red Eléctrica** uses "are quite reliable for the next six hours, and beyond 24 hours out the margin of error is about 15 percent," says company spokesman Antonio Calvo. And Spain is having success managing surges in wind power: Turbines contributed between 2.5 and 18 percent of its energy supply at different points during one day in September.

In Denmark, forecasting hasn't led to less use of coal, says Gitte Agersbæk, a senior engineer at state-owned grid operator **Energinet.dk**. While Denmark often generates more wind power than it needs (and exports the excess to Norway so Denmark's grid doesn't overload), many of its centralized heating systems are powered by coal and need to run constantly in winter. Denmark is starting to grapple with how to make wind a more effective, dominant energy source. Energinet.dk is working with the Danish Technical University to improve short-term wind forecasts and looking for new ways to integrate wind power into its energy infrastructure.

Back in Colorado, Xcel's project with NCAR has been extended for a year. Xcel is able to idle coal stations for as long as three days to accommodate a surge in wind power. "The project has definitely been a success," says Keith A. Parks, a senior energy trading analyst at Xcel.

More benefits from better predictions may be coming, says Frank Mastiaux, the head of E.ON's Climate and Renewables division. "The right wind forecasting is the crucial thing for picking the right sites and later managing the intermittency issues," says Mastiaux. "I do not think we have by far exhausted all the technical options to get that improved." *—Jeremy van Loon*

The bottom line *More accurate wind forecasting could yield big benefits for utilities and turbine makers around the globe.*

67

BILLION DOLLARS

Stimulus funds offered for clean energy under the 2009 American Recovery and Reinvestment Act. Only about half the money has been disbursed so far.

DATA: BNEF

Speed Dial Marvin Odum

The Shell Oil president talks about why he's for a carbon cap, his biofuels play in Brazil, and how long it will take to scale up clean energy.

The push for climate legislation went off the rails this year. What will accelerate the transition to clean energy if the U.S. is not going to have a price on carbon?
We have for years advocated an economywide, market-based [cap]. In the absence of that there are some things we can do. For example, we have a price on carbon inside of Shell. We charge ourselves $40 per ton for CO_2 emissions. That changes the way we think about the business. We're focusing on natural gas, because it's the way you can have the most immediate impact on reducing emissions.

In Brazil, your $12 billion joint venture with Cosan is making a big bet on ethanol from sugar cane.
About 2 billion liters a year. It will make us one of the biggest ethanol producers in the world. On a [life cycle] basis, we see a CO_2 reduction of 90 percent. We're working on a full suite of second-generation biofuel technologies, and the joint venture lets us attach these technologies to an existing commercial-scale operation.

How long will it take for cellulosic ethanol to be economically viable?
Historically, it takes about 30 years for a new energy to represent 1 percent of total energy supply. I'm not saying it has to be that way; you can change it through government policy. Conventional biofuels are just now getting to 1 percent. We've been working on advanced biofuels for a good part of the last decade, but it could be 10 years or more before you see it in a very real way. A price on carbon is the one thing that really kick-starts all of this on a massive scale. Ⓑ *—Eric Pooley*

Michael Liebreich

Focus On

The Perils of Protectionism



A trade war may deliver a short-term boost to domestic companies, but the cleantech industry as a whole would suffer

Take a Western world struggling to escape from recession and high unemployment. Add an industry that's growing rapidly and absorbing more and more government support. Sprinkle on some cut-price competition, notably from China, and what do you get? A growing chorus of complaints around the world about unfair trade practices in the clean energy sector.

In Germany, critics have been protesting for more than a year that the country's feed-in tariff—a premium rate paid to producers of solar power—also benefits Chinese exporters of solar cells and modules. In the U.S., Senator Charles E. Schumer (D-N.Y.) has been complaining for almost as long about the way grants from the country's 2009 economic stimulus package are funneling business to non-U.S. companies that can secure cheaper turbines and finance. To guard against this situation, Ontario's 2009 Green Energy Act requires that local goods and services make up at least 50 percent of the cost of wind and solar projects, a proportion that is set to rise to 60 percent in 2011.

Now it looks as if the rumblings of discontent are taking a more serious turn. On Sept. 13, Japan complained to the World Trade Organization about Ontario's local-content policy. The same month, the United Steelworkers (USW) in the U.S. filed a 5,800-word submission with the U.S. Trade Representative, citing "protectionist and predatory practices utilized by the Chinese to develop their green sector at the expense of production and job creation here in the U.S."

How strong a case do these complainants have? China has certainly done more than any other country to establish a leading position in clean energy. It started by creating demand, adopting its first renewable-energy law in 2005 and ensuring that its domestic utilities captured the bulk of the resulting projects. It supplemented this with a raft of industrial policy measures meant to support the development of its supplier base—cheap loans, tariffs on imported wind turbines, aggressive domestic content rules, and so on. Nothing so unusual there: Developed countries that profess allegiance to free trade have resorted to some of the same tricks.

Recently, however, the playing field has begun to tilt. So far this year the China Development Bank has offered $32.2 billion in low-interest loans to the country's solar and wind manufacturers. Those outfits haven't yet landed big contracts in Europe or the U.S., but armed with export credits that the West is hard-pressed to match, they're making inroads into emerging markets. And Beijing, which controls most supplies of rare-earth minerals, essential for so many clean-energy technologies, is moving to restrict exports—a worrisome prospect for the industry.

So the complaints of protectionism have some justification. Would it be wise, therefore, to take dramatic action? A clean energy trade war would put the brakes on China's headlong drive into the sector. Its makers of photovoltaic solar panels and turbines would lose access to their most significant markets, Europe and the U.S., potentially driving large numbers of them out of business. Such a scenario might benefit populist politicians campaigning on promises of bringing jobs back from China. The share prices of companies such as General Electric and Vestas Wind Systems also might get a temporary boost.

However, all of this would be bad news for clean energy's long-term health. In the absence of foreign competition, domestic manufacturers would demand higher prices. Higher clean energy costs, in turn, would make international accords on emission reductions more difficult to reach than they already are. For developed countries to meet 2020 targets for renewable energy use and emission reductions, they are going to need all the cheap turbines and solar modules they can get. Meanwhile, Beijing, denied access to global markets, might reassess its huge investment in clean energy. It could well decide to give even greater priority to old-fashioned, coal-fired development.

The Obama Administration has until Oct. 24—just eight days before the midterm congressional elections—to decide whether or not to champion the USW's case. The clean energy industry needs to avoid getting into a sector-specific trade war. Instead, it should push for the liberalization of trade and exchange rates and for aggressive but fair competition.

At the Bloomberg New Energy Finance Summit in London in March, Peter Brun, senior vice-president at Vestas, the world's largest maker of wind turbines, put forth a vision of a sustainable-energy free trade area to ensure the most competitive worldwide market for clean energy products, services, and commodities. Eliminate subsidies. Eliminate tariffs. Agree on technological standards. Now there's a battle cry worth heeding.

Liebreich is chief executive officer of Bloomberg New Energy Finance.

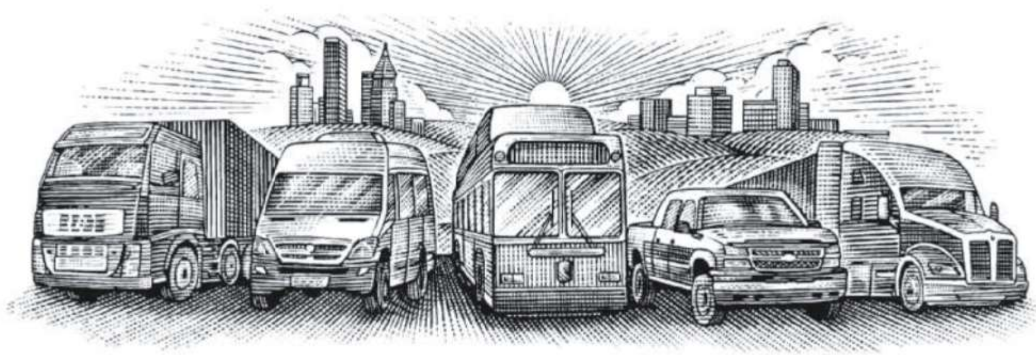
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Natural gas for transportation is not a new idea; it is a proven technology. In fact, it's been around for decades globally. Natural gas vehicles (NGVs) are widely available for rental in Europe. And yet, here at home, NGVs currently use less than 1% of the U.S. natural gas supply.

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per

Vinit Bharara



Can two guys from Jersey outsell Amazon?
By Bryant Urstadt
Photograph by Danielle Levitt

ath

It is good to be the chief executive of a company that's about to ship 500,000,000 diapers in a single year.

For one thing, you get to drive a golf cart as fast as you want in your new 1,250,000-square-foot warehouse.

"Hang on!" says Marc Lore, putting the hammer down.

The golf cart leaps forward, racing through 10-foot-tall canyons of diapers stacked on pallets. At 25 miles an hour, the diaper mountains blur by, here a pyramid of Huggies Little Snugglers with pocketed back waistbands, there a tower of Pampers Swaddlers Sensitive economy size packs. Skyscrapers of Enfamil, Similac, and Luvs Ultra Clean Wipes flash past.

"You could put about 20 football fields in this place," says Lore, CEO of Quidsi, the parent company of Diapers.com, the Internet service that by year's end is expected to ship Diaper No. 500 million. Next to Lore, in the passenger seat, is Vinit Bharara, co-founder and COO. Lore and Bharara, both 39, have been friends since grammar school in New Jersey. Also on board is Scott Hilton, Quidsi's executive vice-president for operations, who designed the warehouse, which is in Gouldsboro, Pa. The place is a third of a mile long; the way Lore drives his cart, it takes him about a minute to travel its

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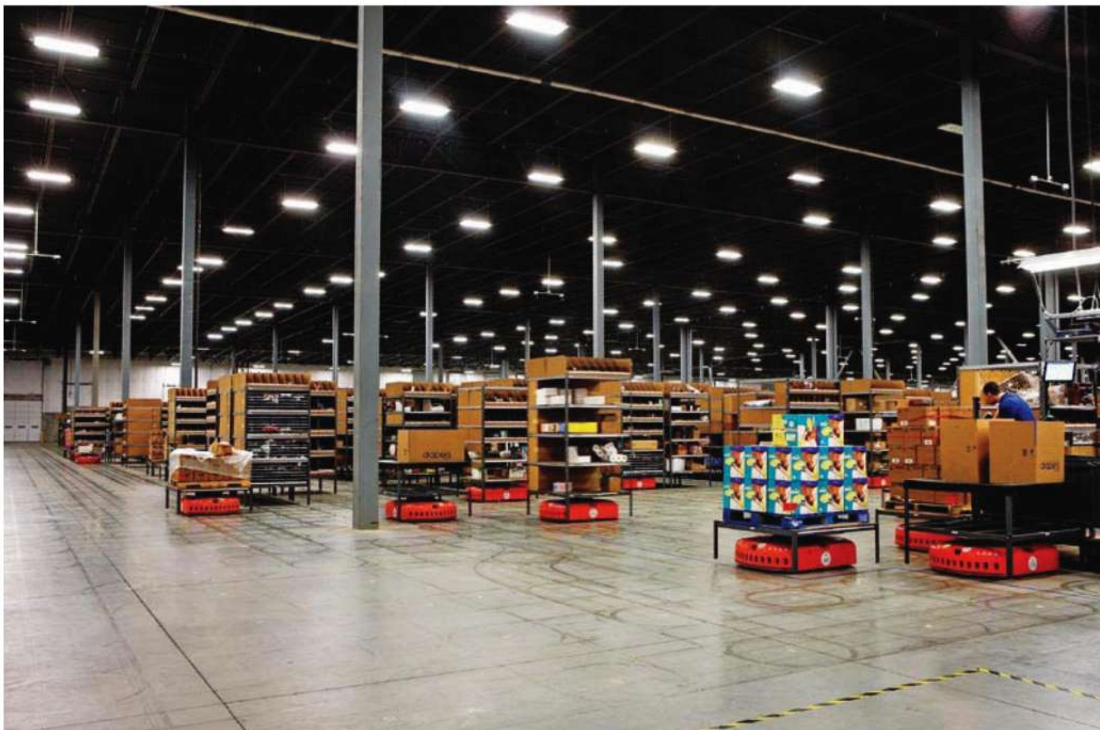
length. High overhead, motion-activated lights flicker to life as he speeds along, leaving a sky trail behind as they zoom past the walls of diapers.

Lore can go almost anywhere he wants inside the warehouse. He can duck through its 53 aisles of supplies with about 50,000 different products. He can slip by its loading docks, where trucks are being stuffed with packages destined for 20 states. (The company also has warehouses in Reno, Nev., and Kansas City, Mo.) But there is one place Lore cannot go. He cannot go where the robots are. The warehouse features about 260 robots, working in a 200,000-sq.-ft. expanse delimited by bright yellow paint and filled with square racks of shelving. They are short, orange, rectangular machines that lift and deliver the shelf pallets to human "pickers" at stations around the perimeter. They move in balletic formation, dancing like the magic broomsticks in *Fantasia*, sometimes stopping and swiveling in place to change direction. They wait patiently for a column of their peers to pass or make orderly lines in front of the packing stations before dropping off their loads. Each robot weighs about 800 pounds and can lift 3,000 lbs. of merchandise.

"They have sensors and they're supposed to stop if they see you," says Hilton. "But it's better to stay out of their way. They're very quiet, and you don't hear them coming."

So Lore avoids robot territory, driving down another canyon and pulling up to a door in a dark corner. Beyond it is an equally impressive space, another 400,000 sq. ft. yet to be used. "Room for growth," says Lore, letting the sheer size of the space do most of the talking. It is easy to understand the message here, and in everything Quidsi does. To survive as a commodity-based retailer you need ridiculous, giddy-making scale—because no matter what you're selling, if you're selling online, you are always, always at war with Amazon.

In the Gouldsboro warehouse, robots do the heavy lifting



PHOTOGRAPH BY DANIELLE LEVITT FOR BLOOMBERG BUSINESSWEEK

Lore and Bharara did about $180 million in revenue in 2009 and expect to bring in about $300 million in 2010. Just five years old, Quidsi (the name means "What if?" in Latin) is already breaking even in a category that wasn't supposed to work on the Internet: quickly shipping bulky, low-margin commodities. The partners don't make money on diapers, and never planned to. Diapers are the draw that brings in loyal customers who order over and over. The money comes when a shopper throws in one of the other 25,000 SKUs, or Stock Keeping Units, that Diapers.com lists on its site—higher-margin items like brand-name baby shampoo, wipes, and formula. (Soap.com, just introduced, adds another 25,000 SKUs. Lore and Bharara want to have well over 100,000 by the end of next year; they're planning to get into toys, too.) According to the partners, their customers are "sticky," ordering again and again and telling other parents about the service. They are also a surprisingly valuable demographic; many are mothers who don't have time to drive over to Costco because they're working and will spend money to save time.

The company started out as 1800diapers.com. Before going live in January 2005, Lore and Bharara spent three years planning and perfecting an easy-to-use site that looked

"We're obsessed with Amazon. We study it like crazy," says Lore. "Recently, I read every 10-K since 1996"

“At first, you’re like, Then you’re like,

like an enormous, professional operation. Their first customer service department and warehouse, however, were anything but. The entire staff consisted of Gina DePaola, now 38, a college friend of Lore’s. The warehouse was her garage in Center Moriches on Long Island. Lore and Bharara tried to get Procter & Gamble to deliver Pampers to DePaola’s home, but they were told that P&G didn’t sell wholesale to businesses that were less than two years old, much less to homemakers’ garages. “It kind of made for a chicken-and-egg problem,” says Lore.

Unable to buy from the major manufacturers, Lore and Bharara forged a practical solution. When an order came into the website, DePaola would run down to the local BJ’s Wholesale Club in her minivan to pick up diapers. Then she would ship them out. Orders started to come in almost as soon as the site went live. By the end of the first week, she was shipping 20 to 30 packages a night. The partners lost money on every shipment but learned that there was a market for diapers on the Internet. They began with a few hundred thousand dollars in seed money, which they spent, and then raised $4 million, and later $54 million, in venture financing. “Our gross margins at the beginning were 4 percent,” says Lore. “We were losing money on every package.”

After a one-line item ran in *babytalk* magazine, about six weeks in, DePaola was shipping 180 packages a night and could no longer fit all the diapers she needed into her minivan—so she got her father, who had a GMC Envoy, to help. They would push cases of diapers through the store and customers would make jokes like, “Triplets, eh?” Eventually she had to start renting trucks from U-Haul and clearing out the entire store. Then she bought from Costco and BJ’s stores farther away. (Strangely, losing money on each shipment increased their cash flow, as they were buying on credit cards with standard 30-day billing periods and selling for payments that came through in two days.) “Pretty soon,” says Lore, “we would clear out all the stores in a hundred-mile radius.” The diapers filled DePaola’s garage and started to pile up on the lawn, until one night, when it was about to rain, they realized they needed a real warehouse.

DePaola also provided the customer service. One customer who called frequently was amazed that she “always got Gina.” Others would demand to speak with the manager, and DePaola would put the phone down, wait a little bit, and then come back as “the manager.”

Around that time, after about five months, P&G figured out that the business was for real and gave them an account. By the end of the first year, they had brought in about $2 million in revenue but had lost all their investment. In 2006, after raising the $4 million in capital, they did $11 million in revenue and had rented a professional warehouse in Virginia. In 2007 they purchased the Diapers.com domain name, though they won’t say for how much. Their headquarters since April 2010 has been a 30,000-sq.-ft. space in a tower in Jersey City overlooking Manhattan, where 85 representatives handle customer questions. There, Lore and Bharara share an office, and even a landline. DePaola doesn’t work for Quidsi anymore. She is not forgotten, however; the conference room in headquarters is named after her. Quidsi now has about 550 employees.

On a perfect July day, Bharara drives out from his apartment in Manhattan and picks up Lore in Mountain Lakes, N.J., for the two-hour drive to the new Gouldsboro warehouse. In Mountain Lakes, Lore takes the wheel, and the two spend the greater part of the trip deep in discussion about two of the topics that interest them most—baseball and Jeff Bezos.

Bezos has been on their minds as both a hero and a rival since they founded Diapers.com. When they talk about him, it is with self-mocking reverence. Lore calls him “Sensei Bezos.”

“We’re obsessed with Amazon. We study it like crazy,” he says. “Recently I read every 10-K since 1996. It’s interesting to read all those 10-Ks in a row. They were doing so many things so soon.”

Lore has just finished reading a 2007 *Harvard Business Review* interview with Bezos, and he passes it to Bharara, who starts right in on it. “He has a senior team strategy meeting every Tuesday, just like we do,” exclaims Bharara.

He reads for a bit more, then adds, “He talks about the marketplace; it’s so clear his No. 1 thing is selection.”

“We know that, too,” says Lore. They’re deep in a conversation that seems to have lasted for much of their lives. After grammar school, they also went to high school together, and though they went to different colleges, they were in the same state—Lore at Bucknell University, Bharara at the University of Pennsylvania—and worked it out so that they could spend a year abroad together in Sweden. After college, Lore went to work for Bankers Trust (“Bezos worked at Bankers Trust,” Bharara noted in an earlier meeting) and Bharara went to Columbia Law School and then to a law firm in New York. In 2000 they teamed up to start ThePit.com, a site that lets sports fans trade players like stocks. It was bought by Topps, the playing card manufacturer.

With so much history, it frequently happens that a topic carries them away and they forget the rest of the world. On their last trip down, they missed the exit to the warehouse. Not long ago, the two were in Lore’s car on the way to a meeting at Procter & Gamble’s distribution center in Mehoopany, Pa., and, while in the middle of a discussion, ran out of gas. After the meeting, the P&G executives honored them with a souvenir gas can.

Their conversations about baseball re-

When Diapers.com launched in 2005, DePaola was the entire staff





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‘How big could that be?’ ‘They’re doing X hundred million in revenue, how is that possible?’”

Industry Analyst

flect an intensely quantitative view of the world. They not only discuss earned-run averages but also more arcane data like slugging percentages, the number of long balls given up, and the OPS, or On-base Plus Slugging statistic. “It’s a nice number because it combines the ability to power hit with the ability to get on base,” says Lore. “For a mainstream statistic, it’s one of the best.” Lore has a mind for math—he worked in risk management at Credit Suisse—and much of Quidsi’s success seems to rely on his gift for precision. The company, for instance, has specified 23 different sizes of boxes to ship in, and has designed a software program that knows the dimensions of each ordered product and can fit them into the smallest possible box, which saves on shipping. The boxes are automatically made at the warehouse and delivered to the pickers by the robots. Quite often, though, the pickers have to work a bit to figure out how the computer wanted the items arranged; it’s a little like a three-dimensional jigsaw puzzle.

Lore has also developed an algorithm for figuring when and how much stock to reorder for a particular item. The goal is to find the sweet spot between having enough on hand and not tying up too much cash in inventory. He figures out when to order by building a “joint probability distribution,” which merges the chance that a product will see a sales spike with the chance that a vendor will take too long to deliver new stock. If you combine these probabilities, you can determine when to order—and be right a certain percentage of the time. If you order far more than you need, for example, you’ll be right virtually all of the time, but at a cost. If you order just a bit more than you usually need, you’ll be fine 95 percent of the time.

Once Lore has decided on a range of percentages that he can live with, say an 85-to-95 percent probability that he’ll have enough in stock, he ends up with a range of units he can order to be happy. Pinpointing a final number—his “ideal economic order quantity”—requires yet another algorithm, which takes into account the size of the order as well as the savings on dealer discounts and shipping, and balances all that against the cost of the cash outlayed and the time the order will take to sell through.

They obsess about sending stuff out, too. “I think shipping is really interesting,” says Bharara on the drive to the warehouse. “We spend a lot of time talking about shipping.”

Soon they’re discussing whether or not they can figure out a way to get orders to people, in Manhattan at least, within an hour, which leads to a long discussion about what to use for the deliveries (pedicabs?), where to store the items, and whether or not to guarantee the one-hour delivery time.

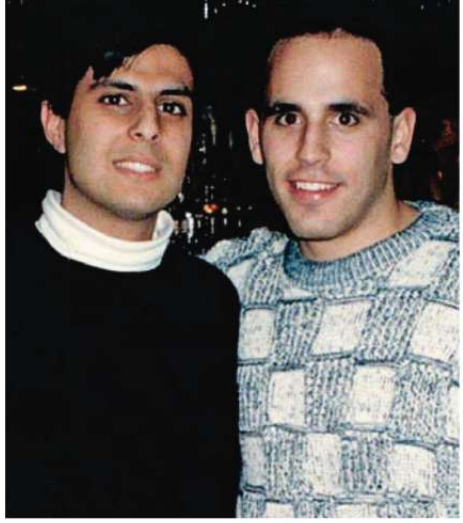
In many ways, they see shipping as their advantage. Quidsi will ship orders over $49 for free with a delivery time of 2 days, with 74 percent of their shipments going out overnight. Amazon.com, through its Prime program, which costs $79 a year to join, will offer two-day shipping as a standard option. (Until recently, Quidsi even sold through Amazon as an associate, much as Target and Drugstore.com do, under the 1800diapers.com name. It stopped, saying the fees “killed” profits there.) Amazon, does, of course, offer many items that you can get in two days, but Quidsi’s focus on diapers allows it to excel in that one area. Quidsi uses different shippers to deliver to different places, depending on the rates, which vary by zone. If they can save money by filling their own truck with orders and driving them from one zone to another, they’ll do that.

Lore returns, inevitably, to the topic of Amazon. “In 1997,” he says, “they had $60 million in sales and 137 employees, and Barnes & Noble was going to start selling books online, and some analyst called them Amazon.toast.”

“Hey!” shouts Bharara, twisting in his seat. “We missed the exit!”

Quidsi has a chance to compete with Amazon, says Jordan Rohan, an analyst with Stifel Nicolaus, because it’s specialized. Though Quidsi is not a publicly traded company, Rohan says he watches it closely, and not only because he’s ordered about $1,000 worth of diapers, formula, and wipes from them since his son was born.

“I’ve seen everything from Pets.com to every other crazy idea go up and down,” says Rohan, who has covered the Internet retail since 1999. “At first, you’re like, ‘How big could that be?’ Then you’re like, ‘They’re doing X hundred mil-



Lore:
At the beginning, "we were losing money on every package"

Bharara:
If Amazon wanted an all-out price war, "I would definitely take that challenge"

lion in revenue, how is that possible?' But this is now a nationally recognized Internet brand with a decent likelihood of becoming a billion-dollar-revenue business. I have to respect what they've built so far."

It's Diapers.com's focus that makes it dangerous. The same focus allowed Zappos.com to dominate the shoe business on the Internet, a success that led to Amazon's $1 billion-plus purchase of the company in November 2009. "An intense focus on a category enables efficiencies that even Amazon would have trouble replicating," says Rohan. "You can optimize your business. I think specialization with scale is going to be the central theme for e-commerce for this decade."

The launch of Soap.com has also impressed him. "Soap.com is doing $1.8 million of revenue in a month, in its first month," he says. "That's $20 million a year. That's way more than I expected, and I would call that extraordinarily successful." Three weeks later, in early October, Quidsi estimated it would do $40 million in sales this year. "It's just that many more things a customer can throw in the box with the diapers," says Lore.

Specialization works for companies like Quidsi and Zappos because they build relationships with recurring customers, and because they can get their product out quickly. Bharara and Lore, for instance, are experimenting with local city storage of most-ordered items, so that a case of diapers might appear at the door within hours. Amazon can't move its huge selection into urban areas, but most Diapers.com customers are selecting from a small and predictable range. Specialization also works because you can design a website targeted to a particular audience. Start at the home page, and you're almost done shopping.

Amazon.com executives would not comment for this story, but the company is clearly aware of Quidsi. It started selling diapers in the summer of 2006, just a year after Diapers.com debuted. When Quidsi launched Soap.com in July, adding an additional 25,000 products to their lineup, the site was strafed almost from the minute it went live by price bots dispatched by Amazon. Quidsi network operators watched in amazement as Amazon pinged their site to find out what they were charging for each of the 25,000 new items they initially offered, and then adjusted its prices accordingly. Bharara and Lore knew that would happen. "If we put something on sale, we usually see Amazon respond in a couple of hours," says Bharara.

Or as Rohan puts it: "A price bot attack truly is the sincerest form of flattery."

Mick Mountz is CEO of Kiva Systems, the company that builds the orange robots in Quidsi's warehouses. He also worked at Webvan, the company that lost $1 billion from 1999 to 2001 trying to be the first to build an efficient online grocery store delivery system. "The problem with Webvan," he says, "was figuring the economics inside the warehouse. Plastic buckets were getting routed all over, and it could take hours to fill one. We would put one tote into the conveyor system and it might pop out two and a half hours later with one tube of toothpaste. There were four and a half miles of conveyor belts in there." So Mountz rethought the whole Web commerce issue as an efficiency problem. He believes Webvan would still be around if Kiva had existed in 1999. One of Kiva's other customers is Zappos. Amazon, as a whole, however, is not, yet.

So much work has to go into efficiency because shipping diapers and household goods is a hard way to make money. Shawn C. Milne is an Internet analyst at Janney Capital Markets, and when he talks about Quidsi and Amazon, he talks about scale, scale, scale. "It's all about driving high volume over fixed costs," he says, meaning you've got to spend a lot and sell a lot. "These are not 15 to 20 percent operating margin businesses, these are 5 to 7 percent *peak* operating margins." That's a low return, but it's a return in a business that's been growing at around 10 percent annually while retail overall has been slumping.

"Will Amazon respond by getting more aggressive? Or potentially look at an M&A opportunity?" Milne asks. "We're keeping an eye on that. Over time, Amazon will start to take notice." Milne, too, orders stuff for his kid from Diapers.com.

While the partners are going back up the interstate, to get to that missed exit, Lore mentions that he has just finished a book on Sam Walton. "They did $1 billion of business until about 1980," said Lore. "In the '70s they were growing just like we were growing, the same numbers exactly, but they were doing every two years what we're doing every year." Even when Lore is reading about Wal-Mart, however, he seems to be reading about Amazon. "In 1962," he continued, "when Sam started Wal-Mart, Woolworth's was the biggest publicly traded company on the Dow." It is as hard to imagine a world without Amazon now as it was to imagine a world without Woolworth's in 1962, but the thought has occurred to Lore.

And if Amazon wanted a diaper war, an all-out price and delivery-time smackdown? "I would like that," said Bharara. "I would definitely take that challenge."

The two will undoubtedly get their chance. In September, Amazon introduced Amazon Mom, a program offering a free three-month trial of Amazon Prime for mothers ordering diapers and other baby items, and an obvious counter to Diapers.com's free shipping. Diapers.com, meanwhile, rolled out same-day delivery in Manhattan and will offer 25,000 toys under the forthcoming yoyo.com, further challenging Amazon in the battle to sell to new moms.

The diaper wars are on. Ⓑ

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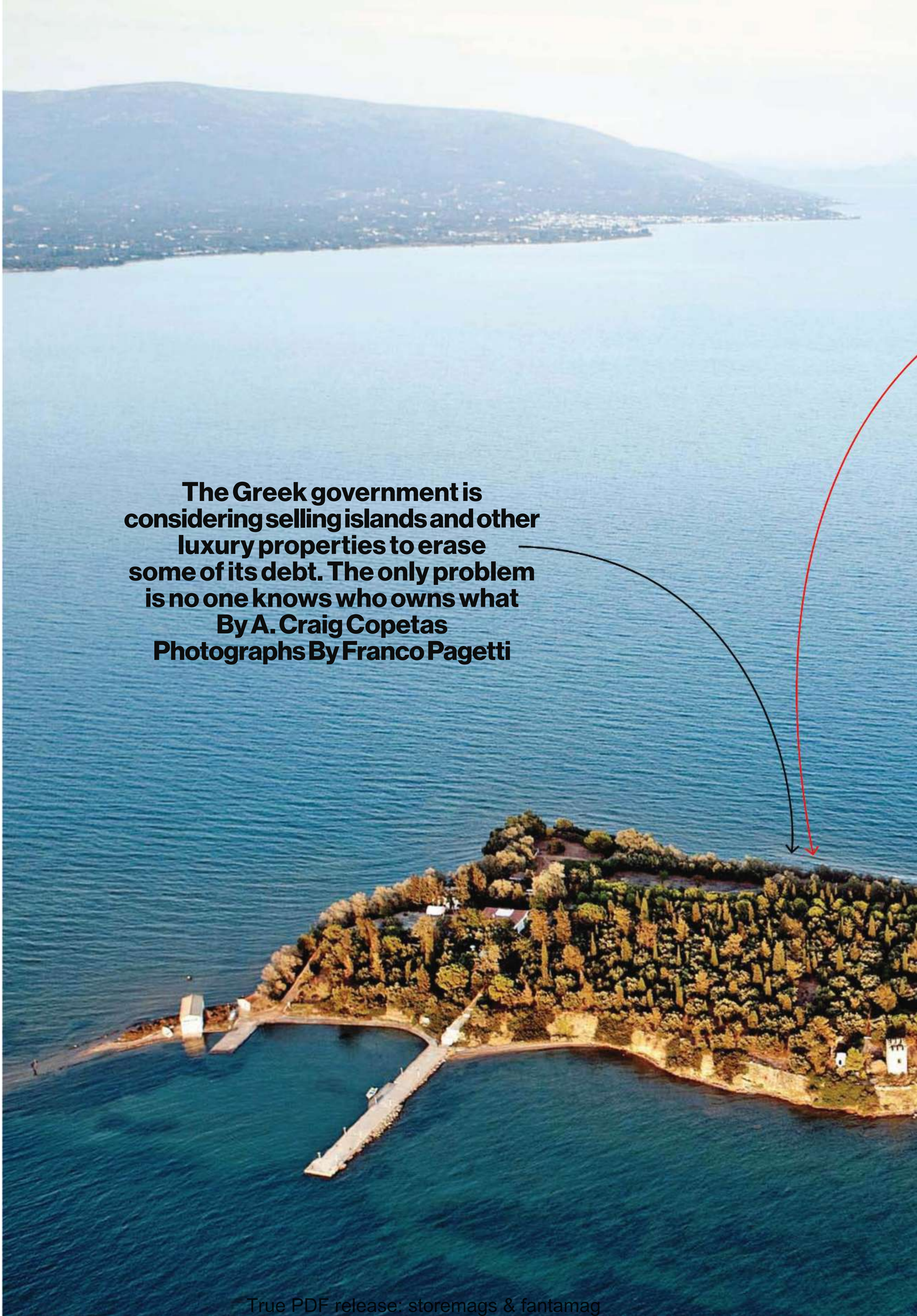
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The Greek government is considering selling islands and other luxury properties to erase some of its debt. The only problem is no one knows who owns what

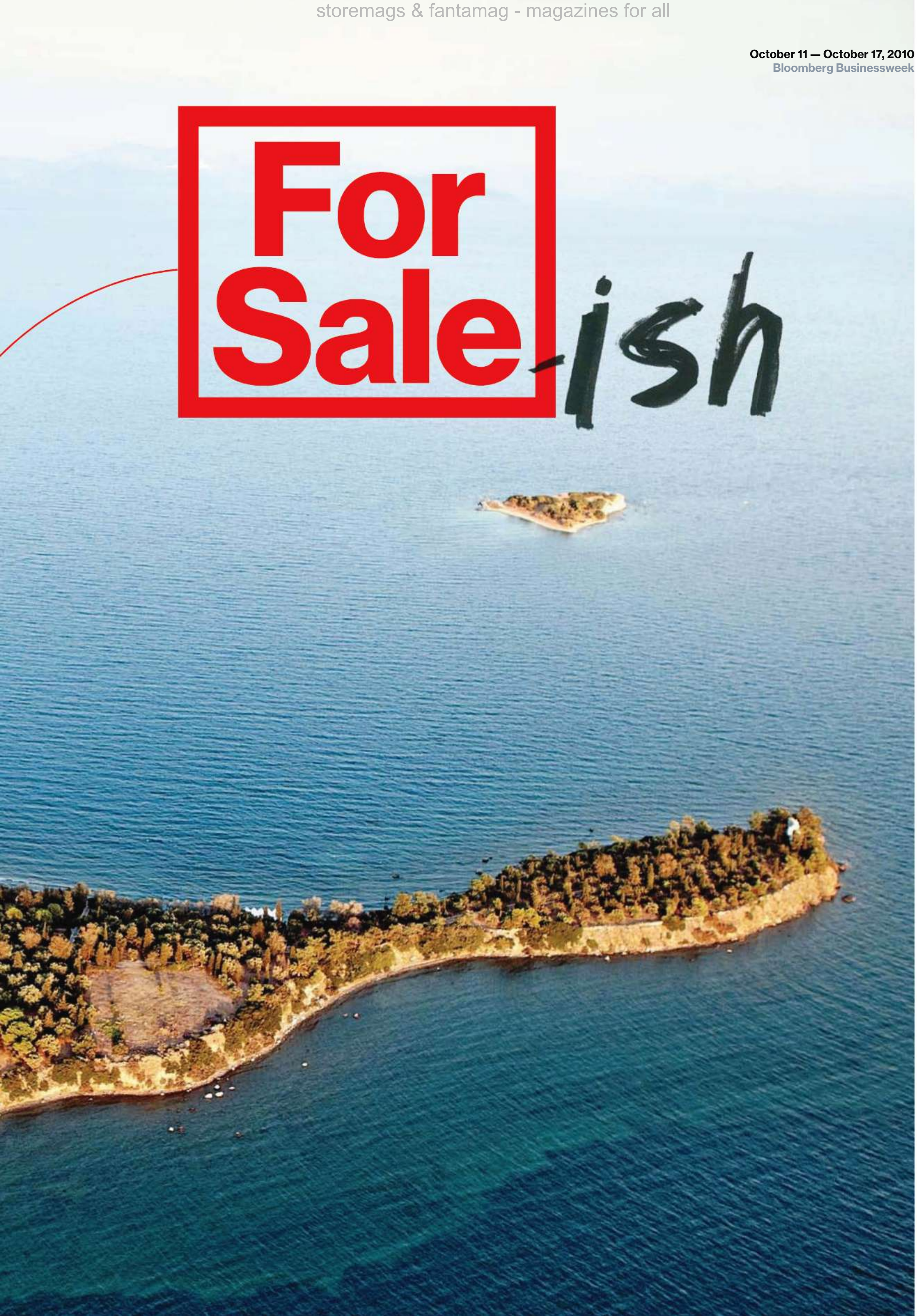
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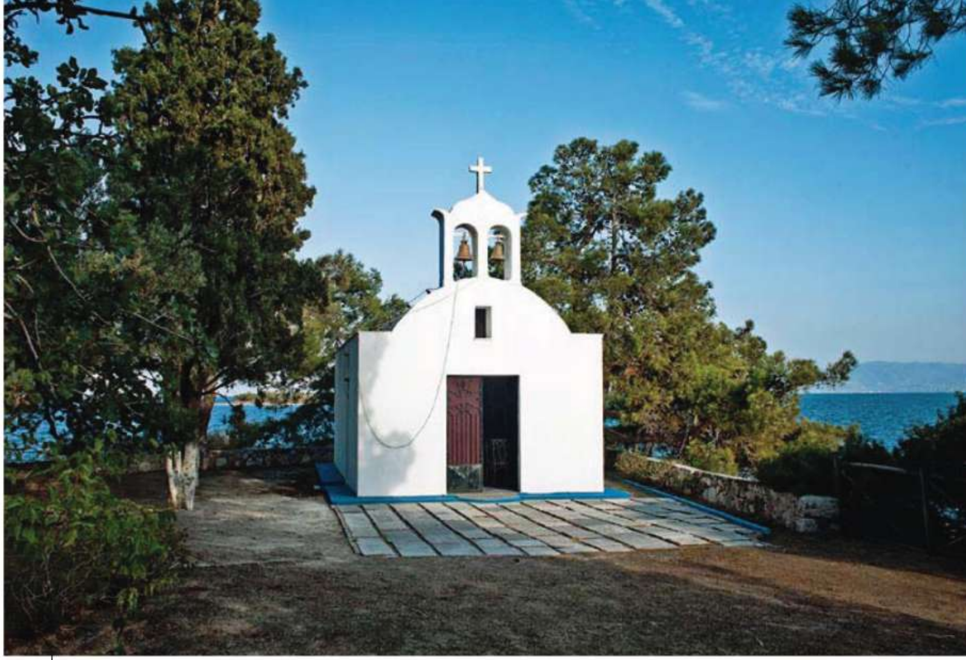
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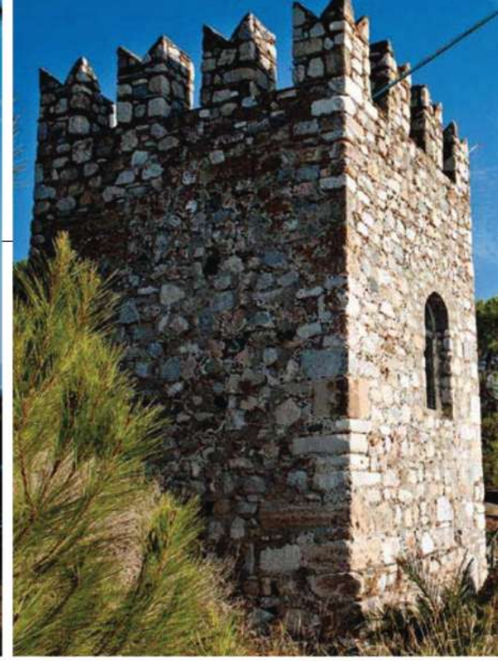
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For Sale-ish







If you build a church, the archdiocese will issue a building permit

A 17th century Venetian tower on Holy Ghost Island

Shortly before Easter in 2008, Antoine Maalouf arrived at the offices of the Greek Tourism Minister with an unusual request: He wanted to buy a Greek island. The 63-year-old general director of the Monaco-based investment company MMC Group slid €15 billion, in the form of guarantees issued by some of the largest financial institutions in the U.S. and Europe, across the mahogany conference table, right under the minister's nose.

Maalouf's idea was simple. He and his investor group would pay €120 million for Patroklos Island—a barren 1,000-acre strip in the Saronic Gulf nicknamed "Donkey Island" by fisherman—and construct a Las Vegas-style theme park. It was a short boat ride from Athens, and Maalouf planned to pack it with casinos, golf courses, luxury accommodations for 50,000 people, and a marina for thousands of yachts. The project would employ 8,000 Greeks at a time when the country was hurting for jobs. Donatella Versace had signed on to build a luxury hotel.

"All I needed to start was a letter that promised government assistance in overcoming Greece's ridiculous bureaucracy," Maalouf says. "I wanted commitment, an official written commitment."

In response, Maalouf claims, Tourism Minister Fani Palli-Petralia said: "The Greek government gives you its full support," and, "you have our blessing."

"So, you will give me the letter?" Maalouf repeated.

"What?" Palli-Petralia asked him. "You don't trust the government of Greece?"

Maalouf says he never got his letter, and his Donkey Island development project died, a victim of the kind of bureaucratic paralysis and institutionalized corruption that Prime Minister George Papandreou is now struggling to bring under control. Greece is expected to owe its creditors €400 billion by 2012, following a bailout of the Greek economy by the European Union and International Monetary Fund earlier this year. Confronted with monthly debt payments of €4 billion, Papandreou, while at the January 2010 gathering of the World Economic Forum, suggested a strategy that ailing companies often pursue when fighting for survival: selling prized assets. The most valuable treasures that Greece has to offer are its 6,000 sun-soaked islands, which, along with luxury properties and other land the government controls, could fetch a healthy premium on the open market.

Most of Greece's islands are in private hands, and are valued between €3 million and €150 million. While the government doesn't own them, it benefits from the sales through tax revenue and development, which creates jobs and attracts tourists. As a result, the state is involved in every aspect of any transaction, from authorizing a deal to regulating every detail of who might buy a property and how much they will pay. This puts consenting adults at the mercy of the Greek bureaucracy. Although no sales have taken place since Papandreou first floated the idea, the possibilities are immense. The Ionian Sea boasts Skorpios, the legendary compound of Aristotle Onassis. To the east lie the islands of Spetsopoula, owned by the Niarchos family, and Koronida, the retreat of the Livanos clan. The list goes on. The trouble is that the labyrinthine federal, state, local, military, and religious regulations, decrees, laws, proclamations, and edicts have made it

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The Papanikolaou family is trying to sell the island for €20 million

"Right now," says Stratigis, "there are court battles over land disputes that stretch back to 1838"

nearly impossible for anyone to sell anything, because no one can agree on who owns what.

Greece is not the only modern nation that has faced calamitous budget shortfalls and needed to sell state-controlled land and other assets to keep creditors away. Between 1993 and 1995, for example, 20,000 of Russia's 27,000 state enterprises were sold for about 10 percent of their value to raise capital, according to Kremlinologist Boris Kagarlitsky, director of the Institute of Globalization Studies and Social Movements in Moscow.

"Greek islands cultivate more curiosity from foreign investors than discussing our debt-to-GDP ratio with a guy who wants to build a chain of shopping malls with tax breaks on tendered government land," says Mike Vassiliou, director of the Greek real estate firm NAI Global, who serves as an adviser to the permanent IMF monitors now scrutinizing plans to sell or lease state-owned properties to service creditors. What he means is that offering islands might lure all sorts of buyers who could end up making badly needed investments in Greece. "But the government so far refuses to create boutique offerings that attract entrepreneurs and private investors. If you come in with €200 million to invest, the government claims it will help you cut through the bureaucracy. A penny less and you're on your own in the labyrinth."

Despite Papandreou's enthusiasm for the idea, actually buying a Greek island is maddeningly difficult. Prospective purchasers often spend more time and money negotiating the ultimate sale price with government bureaucrats than with the property's actual owner. And then there's the challenge of trying to figure out who really owns the land. "Right now there are court battles over land disputes that stretch back to 1838," says former Secretary General of the Greek Ministry of Economy Stratis Stratigis, who once headed the Athens Olympic Organizing Committee and served as legal counsel to Maalouf's bid for Patroklos. "We still don't have a land registry."

The EU gave Greece nearly €60 million to create a land record office in 1994. But, according to Petros Doukas, a former Deputy Finance and Deputy Foreign Minister, "the EU demanded some of its grants back. The cost of creating the registry somehow escalated from €1,300 per square kilometer to €30,000 per square kilometer." An independent study undertaken by Vassiliou earlier this year is perhaps the closest thing Greece now has to an official land registry. Scouring the country's court records, Vassiliou says he discovered that the state is currently disputing 675,000 acres of land claimed by individuals. The Greek Orthodox Church is wrangling in the courts over its ownership of a further 325,000 acres. Stratigis calls the crisis one of basic arithmetic. "Greek governments," he says, "never learned how to count."

No story better illustrates the through-the-looking-glass quality of Greek land ownership than that of Holy Ghost Island, a 12-acre, guitar-shaped slip of rocks and trees in the Gulf of Evia where the Beatles once slept. The rock group spent three years trying to buy Holy Ghost from its owner, Sophocles Papanikolaou, the chancellor to the Greek Royal Court in the 1950s and 1960s (Papanikolaou's cousin, Dr. Georgios N. Papanikolaou, was the inventor of the Pap test for women). Despite their best efforts, though, the Beatles failed. (They ended up buying another island, which they sold a few months later). The island's name in Greek is Agia Triada, or Holy Trinity. Still, some official maps identify the place, which is

"The biggest problem I face is the bureaucracy," says Papaioannou. "Maybe it's time to slap them in the face"

50 miles by road and boat north of Athens, as Trinity Island. The island's caretakers call it St. Trinity, but the story changes if one consults with the Greek Orthodox Church. The priests say the patch of 300 olive trees and copses of almond trees is called The Island of the Father and the Son and the Holy Ghost, and they'll gladly help carve a path through the bureaucracy if you promise to erect a chapel. "If you want to construct a new house on any property, build a church and the archdiocese will issue the building permit," explains Katerina Samaropoulou, the tall, tan principal of the island real estate firm A. Samaropoulou & Associates. "The new house is now called the xenona, the parish guest house. The swimming pool becomes the kolibithra, a baptismal font. No tax."

The fishermen have their own name, Holy Ghost Island, where the phantom of a despondent lover is said to haunt a 17th-century Venetian tower. The official listed sale price is €20 million. Except at the Greek tax office.

Marielle Kzoni, the lawyer who represents the Papanikolaou family on the sale of Holy Ghost, pours coffee beneath a pomegranate tree and attempts to untangle the confusion, while petting two dogs, Mythos and Enos. "There's a 9 percent tax on the €20 million sales price," Kzoni says. "But the local tax office values Holy Ghost at around €1.5 million. So we make the sales contract that goes to the tax office read €1.5 million. You pay the seller €20 million, but only pay the government 9 percent of €1.5 million. The tax office is fine with that. Cheap, yes?"

Confusion over land value is apparently only one of the challenges buyers and sellers face when attempting an island transaction. "Eight ministries, from Culture to Defense, are involved in the initial purchase of a Greek island," Samaropoulou says as twilight settles over Holy Ghost. "Then, once you have the eight ministries signed on, and depending on where the island is and its legal status, you go back to the Finance Ministry to see if they want to buy it at the tax-office price."

All non-EU citizens must undergo a further check by the Defense Ministry to ensure they don't pose a military threat to Greece in the event of a Turkish invasion. "The most traumatic transaction in Greece is buying an island," Samaropoulou says. "You're looking at around 2,500 official licenses and permits to conclude a sale. My 60 serious foreign clients interested in buying islands find this amazing and unbelievable.

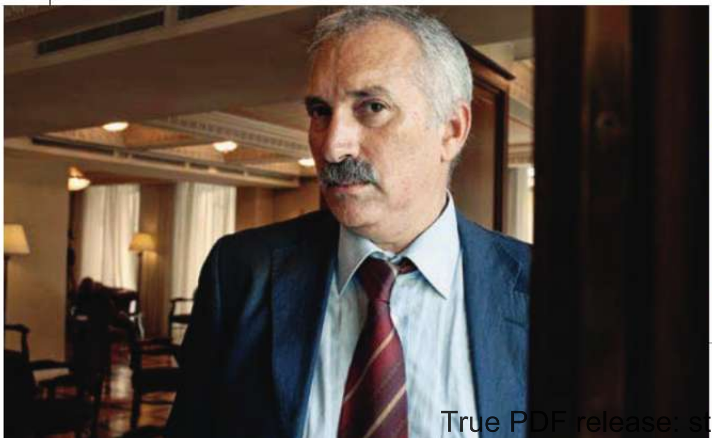
"We estimate the government will put €300 billion of state land on offer, a minimum 15 percent in luxury beachfront and island properties," Samaropoulou continues. "Can you imagine the chaos?"

In anticipation of such mayhem, the Papandreou Administration hired George Papaioannou, the chief executive officer of Piraeus Real Estate, a unit of Piraeus Bank, to assess, value, and dispose of government-owned real estate by sale or lease and bring order to the Greek island transactions. His team's office is next door to the money museum in Athens, eight floors above a mostly empty shopping mall. They have 50 properties to dispose of throughout the country. "I'm one of the coaches, the man who's telling the government what they have and how to best sell it," Papaioannou says. "Don't ask me how many acres we have, because nobody really knows."

He doesn't yet know the details, for example, of the 25 acres of undeveloped beachfront property on the island of Rhodes that the government asked him to assess for the state-owned electrical power company to sell. "It might not even be 25 acres," Papaioannou says, lighting a cigarette. "It's the squatters. We don't know how many there are living on the land."

Papaioannou's calculations also indicate the government has €300 billion worth of land available for sale to investors. History's last recorded state land sale of such scope was the Louisiana Purchase in 1803, when Napoleon sold 828,000 square miles of North American land inhabited by 74,556 people to

Vassiliou is advising the IMF on the sale of state-owned properties



"Is €20 million too much?" Kzoni asks about Holy Ghost



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Pappas and Samaropoulou, working through the red tape

the U.S. for $15 million. Like Greece today, France was in desperate need of cash to pay its debts. President Thomas Jefferson shipped Napoleon $3 million in gold bullion and let the emperor finance the rest through bonds issued by Baring & Co. in London and English and Dutch investment houses. "If you put [€300 billion] on the creditors' table, it will cover the fiscal problem," Papaioannou says. "But it's up to the government to decide. The biggest problem I face is the bureaucracy. Maybe it's time to slap them in the face."

Renee Pappas, a former adviser to Deputy Foreign Affairs Minister Theodore Kassimis and Deputy Finance Minister Doukas, is a founding member of Foreign Investors in Greek Development, a private group whose mandate is to attract foreign capital and guide small businesses through the alien bureaucracy. Over the past eight years, she says, her organization has seen investors wielding €100 million of potential investment capital from South Africa, Switzerland, Belgium, and Australia give up and leave the negotiating table. "Greece is an immature country of bickering children and, like all children, they need a guardian," Pappas says. "Foreign investors interested in state land won't put up with the bribes and political pressures."

In 2004 former Defense Minister Spelios Spilitopoulos sensed that Greece might be heading for financial disaster, and decided to calculate the value of all the real estate his ministry held in a bewildering portfolio dating back to the late 19th century. The resulting three-year study yielded an 84-page report, *Ministry of Defense Evaluation and Survey of Land*, that was delivered to a parliamentary committee in 2007. It listed among its 2,500 properties 30 acres of land on the island of Mykonos with an ocean view, valued at €500 million; a few hundred acres of beachfront property south of Athens near the Temple of Poseidon, undervalued at €100 million because squatters had taken over most of the land; and a 5,000-square-foot penthouse apartment on Queen Sophia Street in Athens valued at €8 million, which was rented to a bureaucrat for €200 a month.

Much of the land that the Defense Ministry accumulated over the years was willed to the military by families who wanted to help fight the Turks. These "patriotic donations" continue to this day, and, according to Stratigis, notaries public and attorneys are legally obligated to ask their clients how much they plan on giving to the military in their final wills and testaments.

At the same time, Spilitopoulos says, various groups within the defense and other ministries attempted to thwart his investigation in the hopes of leveraging the confusion to wrest property from his oversight and control. The assets of the Greek army, for instance, are maintained by the Finance Ministry rather than Defense.

Spilitopoulos, who resigned his post under pressure in 2006, says the report has been ignored and the fight over who owns what won't end anytime soon.

Over at the offices of Capital Partners, former Deputy Finance Minister Doukas fiddles with a pencil and mulls the worst-case scenario. "They'd never do it, though what a national disgrace if the IMF and the rest of the creditors demanded to dispose of the assets themselves," Doukas frets. "We're looking at €4 billion a month in maturity payments on the loans, and this is sailing in uncharted waters."

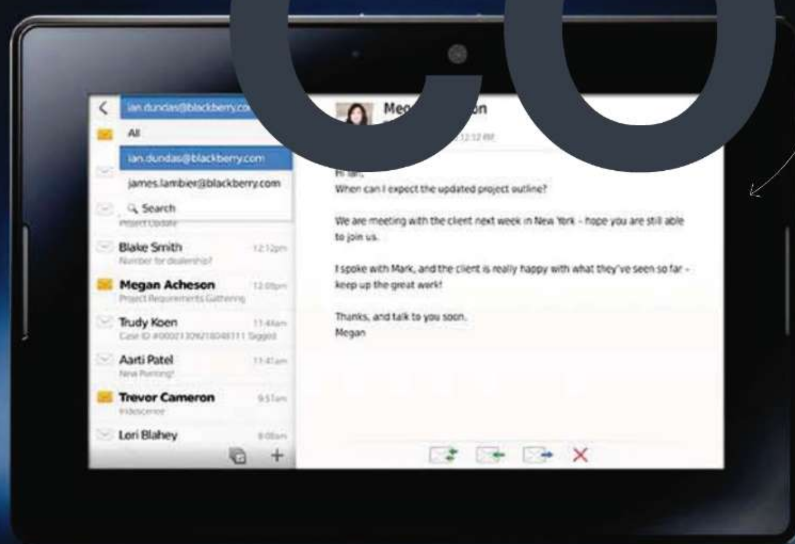
Across the choppy sea on Holy Ghost, the chaotic process of selling the island the Persians used as a staging area for the Battle of Thermopyle continues. Kzoni and Samaropoulou say they'd found a potential buyer, a Kazakh billionaire whose name they would not give up. He was ready to move in, but was jailed in Kazakhstan before the deal went through.

Kzoni says the bureaucrats aren't likely to disappear. "Is €20 million too much?" she worries aloud. "With all the problems, maybe the price should be lowered." B

The BlackBerry still dominates in the corporate world, but the iPhone gets all the love. That leaves RIM's co-CEOs struggling to be heard.

By Diane Brady and Hugo Miller

The PlayBook could be great, but will anyone get the message?



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FAILURE TO COMMUNICATE

When Apple Chief Executive Steve Jobs unveiled the iPad last January, he took the stage in his inevitable jeans and mock turtleneck, and held his new tablet computer like a precious jewel. The device, he told the crowd, was a "truly magical and revolutionary product," something "extraordinary" and "unbelievably great."

Jim Balsillie, the co-CEO of Research In Motion (RIM), has a different approach. When he came through New York on Sept. 24 to introduce the BlackBerry PlayBook, his company's answer to the iPad, Balsillie wore a gray suit and a tie covered with ducks. Kicking off a visit to *Bloomberg Businessweek*, he said: "There's tremendous turbulence in the ecosystem, of course, in mobility. And that's sort of an obvious thing, but also there's tremendous architectural contention at play. And so I'm going to really frame our mobile architectural distinction. We've taken two fundamentally different approaches in their causalness. It's a causal difference, not just nuance. It's not just a causal direction that I'm going to really articulate here—and feel free to go as deep as you want—it's really as fundamental as causalness."

Those words—brilliant, no doubt, if you could only figure out what they meant—illustrate the promise and peril of RIM. On a technical level, the PlayBook may well be better than the iPad. It boasts a seven-inch screen, the same security features that made BlackBerry famous, dual cameras, and support for the Adobe Flash technology that underpins most Web sites. Morgan Stanley analyst Ehud Gelblum wrote that its technical features appear "to outperform competing device hardware on nearly every metric." If Balsillie and his team can't sell it, however, none of that will matter. And RIM hasn't had much luck generating excitement among investors lately. The Waterloo (Ont.) company's stock is down 37 percent since its high in March, to $48.01, on Oct. 6. Its U.S. sales dropped 2.9 percent in the last quarter, to $2.2 billion.

Of course, it's hard to compete with Apple—and it doesn't help when your leader has a hard time making his vision understood. Ask Balsillie if management's message might seem a bit cerebral and he responds that it's "authentic." Maybe so, but RIM's recent product launches have underwhelmed reviewers, and nobody knows how well the PlayBook really works because Balsillie's partner, co-CEO Mike Lazaridis, didn't demonstrate its functions at the official launch on Sept. 27. Devotees of the iPhone like to dismiss the BlackBerry as outdated, one-dimensional, and as sexy as a mid-1970s calculator. Yet RIM's problems don't begin and end with Steve Jobs. While Apple's second-quarter global market share rose to 13.1 percent from 12.4 percent the year before, according to IDC, it was Google's Android operating system that truly surged, rising to 15.8 percent from 2.3 percent. (RIM came in at 17.5 percent.) What Android and the iPhone have in common are operating systems that encourage third-party applications, allowing users to customize each phone with mobile apps that do everything from tracking ocean currents to locating nearby pizza parlors. It's an arms race in which RIM hardly competes. The iPhone has about 250,000 consumer apps, and Android about 75,000; BlackBerry has just over 10,000.

To some on Wall Street, like investor Buzzy Geduld of Cougar Trading, RIM looks like a company on the precipice. "They need that revolutionary product," he says. Nobody has achieved a seamless mobile Web experience; if the PlayBook succeeds, it may turn out to be a coiled spring. Look at the numbers and it's also clear that RIM is anything but dead. It's still the dominant smartphone for business, with a 41.5 percent share of worldwide business use, vs. 17.5 percent for Apple, according to IDC. It beat Wall Street expectations when its earnings rose 68 percent and revenue jumped 31 percent in the quarter that ended Aug. 28. Even RIM's reputation for security arguably got a boost when Saudi Arabia, India, and the United Arab Emirates recently threatened to shut it down because it's tough to monitor BlackBerry messages. "It's the No. 1 smartphone in the U.S., and in places like Latin America it has incredible cachet with the younger generation," says IDC Vice-President Stephen Drake. "It kind of puzzles me why people are so quick to write them off."

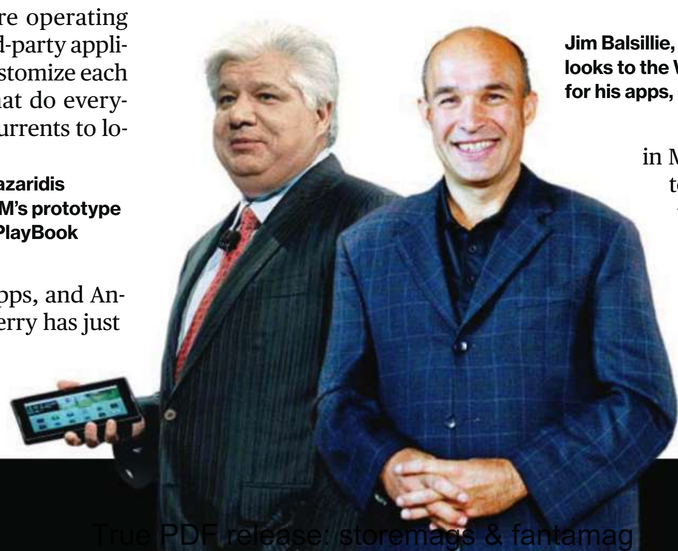
"We don't blow anything out of proportion ... Our whole messaging is authentic. Those aren't actors in our commercials. We've always stayed true to ourselves." —Mike Lazaridis

Maybe they can't understand the story. Balsillie says he didn't want to tell it until the technology was ready, but RIM has been slow to the marketing game. The first BlackBerry TV ad ran in 2008, nine years after the product was launched, when it was already racking up sales of more than $6 billion a year. (Sales hit almost $15 billion in the year that ended Feb. 27.) RIM hired its first chief marketing officer, Keith Pardy, last year. It lacked a full-time chief financial officer—critical for communication with Wall Street—for more than two years until former chief accounting officer Brian Bidulka was formally named to the job last December.

Then there are the co-CEOs, who have split the top job since 1993. Lazaridis, 49, is a Turkish-born whiz kid who grew up in Windsor. Ont., and dropped out of college to build an industrial display network for General Motors; he founded RIM in 1984. Balsillie, also 49, joined in 1992. He's a tradesman's son from rural Ontario who went to Harvard Business School. Each is more comfortable talking about the desires of chief technology officers than the needs of the average person. To hear Balsillie talk, it's easy to forget that more than half of RIM's 50 million subscribers are individual consumers. "You hear this cliché, the consumerization of technology, and I don't buy that," Balsillie says. "When I talk to CIOs, users may want to consumerize, but I have to maintain enterprise greatness."

Those chief information officers, though, are increasingly happy to have employees bring their own smartphones to work. It's cheaper than issuing corporate BlackBerrys that users then expense each month, and companies such as Credit Suisse get around the security issues by encrypting their data through third-party software. "I don't care what device someone has," says Steve Hilton, the bank's head of technology infrastructure services. "We want to get out of the game of managing the system for those devices." Then there's London's Standard Chartered Bank, which announced in May that it's switching completely to the iPhone because of the opportunities to develop more apps.

Balsillie thinks the world is wrong about apps. Many are just glorified bookmarks, he argues, that aren't necessary if you can connect customers to the Web. "I'm not going to bring developers to the Web. I'm going to make



Mike Lazaridis with RIM's prototype of the PlayBook

Jim Balsillie, co-CEO, looks to the Web for his apps, not a store

FROM LEFT: DAVID PAUL MORRIS/BLOOMBERG; DAVE CHIDLEY/THE CANADIAN PRESS/AP PHOTO

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mobility Web-friendly," he says. "Why do you need a YouTube app if you play YouTube? Why do you need an app to follow the Tour de France if you can just follow the Tour de France?"

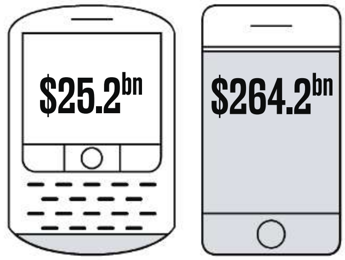
Balsillie has a point—or he would if the consumer universe operated logically. "But we're not living in a perfectly rational world," says Roger Entner, head of telecom research at Nielsen. "People are now living with a very app-centric mindset."

That's why Apple remains the biggest threat to RIM. The marketing and design juggernaut has even turned its retail stores into an entertainment experience. As Wharton marketing professor Eric Bradlow notes, "Apple has done a great job of constructing the playing field and defining what these products should do. RIM is functionally superior, but people are evaluating it on attributes that Apple has defined." RIM's response, he and other critics say, has been to issue "me too" products while refusing to acknowledge Apple as a potent competitor. Some analysts have reacted to its latest offering, which doesn't go on sale until next year, as a sign of desperation. "This was essentially more of a vision statement than a product," says Rodman & Renshaw analyst Ashok Kumar, who argues management is losing its credibility.

Zach Nelson, CEO of application developer NetSuite, calls RIM's strategy of developing a tablet for the business market "a genius idea" but says the pressure is on to deliver a game-changing product. "Now is their time to respond," he says. " I think management will be judged more by what they do in the next year than by what has transpired in the last year."

Management experts have long called a co-CEO structure a recipe for infighting and ineffectual leadership. Yet few consider it a source of RIM's problems. The twin structure does make for some odd work-sharing. Balsillie jokes that they're both so maxed out they could use a "tri-CEO" and concedes the division of labor isn't clear-cut. When an issue needs immediate attention, they trade e-mails to decide who'll handle it. "You play these little games where you try to suggest it to the other guy first," he says. "'I'm really busy, can you handle it?' It's like, dang! You know one of us has got to, and the last thing you want is more work."

Over time, each has carved out a distinct role. Lazaridis, the silver-haired founder and mastermind behind RIM's



Research In Motion's market capitalization pales in comparison with Apple's

DATA: BLOOMBERG

technology, is the face of the company to the tech world. A man who has hosted dinners for Stephen Hawking and poured a big chunk of his wealth into forming the Perimeter Institute for Theoretical Physics, he is regarded as both the visionary and the pragmatist who loves to talk product. "We build professional products," he says. "The more you use them, the more you love them. We don't blow anything out of proportion. ... Our whole messaging is authentic. Those aren't actors in our commercials. We've always stayed true to ourselves."

Balsillie, by contrast, is a former accountant and self-described "quant jock from Peterborough who doesn't quit." His after-work interest is public policy, which led him to create the Centre for International Governance Innovation in 2001 and the Balsillie School of International Affairs, while also serving on a U.N. panel on global sustainability. He's better known in the U.S. for his interest in ice hockey, having unsuccessfully bid twice to bring ailing National Hockey League franchises from the U.S. to Canada.

For both men, the challenge is to sell the world on a single coherent message. Some analysts say RIM needs to do more to cast itself as the killer brand for business, emphasizing its unique advantages. In an era of growing identity theft and privacy concerns—one in which mobile payments may soon become the norm—security is a powerful attraction. "They know what works, and they don't compromise on that," says Kevin Burden, who leads the mobile services practice at ABI Research. "In some ways, it's refreshing to see a company stick to its beliefs. It's a huge misperception to say the BlackBerry platform itself is archaic." The issue, he says, is marketing: "They have to be fresh and new but familiar."

The challenge of adapting a winning formula is hardly unique to RIM. Sarah Kaplan, a professor of strategic management at the University of Toronto's Rotman School of Management, points out that many companies have faltered because they got locked into a system that worked—for a while. "The leaders don't have a mental model to change their way of thinking," she says. Having the technological edge is rarely enough to guarantee sustained success, and most companies wait too long to address incipient threats. Given RIM's insistence on downplaying Apple and claiming that all is well, it's fair to ask whether Balsillie and Lazaridis have spent enough time debating alternate views. Some wonder whether their Ontario headquarters is too far removed from the intense competition of Silicon Valley. "You need a high-conflict, high-respect organization to change the game," says Kaplan. "If there's any issue with being north of the border, it may come down to a fear of conflict."

There certainly appears to be a geographic divide in how RIM is viewed. More than 90 percent of Canadian analysts rate RIM a "buy," while only half of their U.S. counterparts do. Paul Taylor, chief investment officer of BMO Harris Private Banking in Toronto, says some U.S. investors balk at the notion that an isolated Canadian company can be at the forefront of technology. Balsillie acknowledges the disconnect between RIM's performance and investor sentiment, arguing that "it's almost unprecedented." He can't understand why the rest of the world doesn't get it. "The business is doing well and we've got it under control, and wait and see," he says. "What you've got is a true dichotomy of architectural views of mobility here."

That, or maybe a bad connection. Charles Golvin of Forrester Research, for one, sees promise in RIM's recent efforts to promote its brand—from sponsoring tours of rock bands such as U2 to developing TV ad campaigns. "There's tremendous passion out there for RIM, and the PlayBook is an opportunity for them to change their perception in the marketplace," says Golvin. "The question is whether they can get their story out." Basillie may even be aware of the problem. At one point in his meeting with *Bloomberg Businessweek*, he stops and looks around the room, then asks, "Am I communicating O.K.?" B

—With Arik Hesseldahl and Douglas MacMillan

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Brazil Economic Giant In Global Spotlight



An industrial powerhouse, Brazil is roaring ahead at record speed as Latin America's largest country reinforces its reputation as a golden investment destination built on the three core pillars of political, social and economic stability.

In the first three months of 2010, the world's eighth largest economy expanded at its fastest rate in more than a decade, with GDP up a staggering 9% year-on-year due to surging consumer spending and strong foreign demand for its resources.

With a populous of 194 million, business and foreign direct investment (FDI) opportunities exist across a diverse economy in sectors such as banking and financial services, energy, agriculture, retail, telecommunications and infrastructure.

In addition, Brazil's already-booming tourism sector will receive a massive boost from the hosting of the 2014 soccer World Cup and the 2016 Olympic Games in Rio de Janeiro.

With one of the largest and best regulated banking sectors in the region, Brazil's financial services industry has flourished through a combination of market consolidation and a modern approach to banking and investment methods.

Created in 1964, the Central Bank of Brazil is the country's most important and respected financial institution with responsibility for the implementation of government fiscal policy and monetary and financial stability.

From its base in Brasília, the Central Bank controls foreign trade operations and executes foreign exchange operations on behalf of public sector enterprises and the National Treasury as it works to safeguard the country's economic interests.

"The stabilization of the Brazilian economy allowed us to remain resilient to the effects of the global economic crisis," says Henrique de Campos Meirelles, Governor of the Central Bank of Brazil.



Henrique de Campos Meirelles, Governor, Central Bank of Brazil

"We have addressed the main sources of economic stability. Inflation has stabilized and we have stable levels of national reserves as well as sound social and political frameworks."

An industry leader, Banco BVA S.A. and its subsidiaries provide a range of banking products and procedures, plus government-related financial services, including loans from federal development banks.

The company, which is based in Rio de Janeiro, has offices in São Paulo and Belo Horizonte, and is strategically focused on the funding of middle-market companies.

Founded in 1995, the bank is also a partner in successful asset management company Vitória Asset. With a wide range of credit operations, Banco BVA is a leading figure in this fast-growing sector as personal income levels rise, living standards increase and job security improves.

A credit specialist, Banco BVA focuses on small, medium and large-sized companies, and through its successful personalized approach and rapid speed of service, has seen a sharp rise in the number of clients taking out tailored loans.

"We focus on what we know best—which is the middle-market—and we don't work with brokers," explains Ivo Lodo, Banco BVA president.

"Brazil's credit model has recently focused on consumption rather than production, with credit used by consumers to buy cars, houses, clothes, and household goods."

According to Lodo, Banco BVA has outperformed its rivals in recent years due to a combination of its strategic development plan and conservative approach to expansion.

"Our cost-income ratio is good. We have a pragmatic and simple approach and make decisions very quickly," Lodo adds. "The banking industry will go through many changes in the next three to five years and my message to international investors is simple: Believe in Brazil."

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Brazil A Rainbow Of Energy Solutions

Latin America's most powerful magnet for FDI, Brazil benefits from strong flows of capital and financial activities that have allowed its banking and financial services industry to flourish in a competitive environment.

"Brazil's banks are growing: there is solid credit growth. Our financial system provided credit throughout the global economic crisis and we have already restored the level of reserve requirements from before the crisis," says Henrique de Campos Meirelles, Governor of the Central Bank of Brazil.

The largest custodian of corporate fixed income securities in Latin America, CETIP S.A.—OTC Clearing House is a central securities depository and derivatives registrar for operations carried out in over the counter markets.

Formed in 1986 by the Central Bank of Brazil and financial institutions, CETIP ensures the highest levels of safety and efficiency in financial market operations. The company has more than 8,400 clients, including banks, broker dealers, leasing companies, investment funds, pension funds and non-financial firms.

The company, which enjoys an enviable reputation for trustworthiness and reliability, registers transactions made by financial institutions after security measures such as access codes, passwords and other protection-oriented items have been checked.

"CETIP was originally created as a central depository of information; like a big custodian agency for the financial markets," says director general and CEO, Luiz Fernando Vendramini Fleury. "In 2008, we changed from a mutual to a fully incorporated company. We want to position CETIP as the official, independent engine for all over-the- counter, market-to-market transactions in Brazil."

From its offices in São Paulo and Rio de Janeiro, CETIP's flexible, powerful and reliable platform stretches to every corner of the country, with the company ideally positioned to take advantage of growth opportunities created by the booming economy.

"We are very profitable and our focus has always been on efficiency and being a low-cost provider," Vendramini adds. "Research by independent analysts shows that, on average, we cost just a third of what our international competitors charge."

Meanwhile, soaring demand for pensions and insurance cover among Brazil's growing middle class has resulted in a sharp rise in business at Capemisa Life Insurance and Pension.

Born out of industry veteran Capemi, the firm has built on its predecessor's 47 years of experience to boast a client base of more than two million customers, of which 1.7 million hold insurance policies and 350,000 pension plans.

In less than three years, Capemisa has established itself as one of the top 10 independent operators and its strategic development plan forecasts a place in the top five by 2015.

"We are growing well and are one of the most solvent companies in the market," states Capemisa president, José Augusto da Costa Tatagiba. "The relationship between insurance and pension to GDP in Brazil is only 3.5%, whereas in countries like Chile its 5%, and in the United Kingdom 12%, so now we are awake and making changes in a positive market."

Augusto da Costa says that historically, Brazil's insurance industry has always focused on coverage of property rather than people, and his company is raising awareness of the advantages of life cover. "Brazil has many insurance brokers but they are not used to providing personal insurance plans so we are showing them this is the best option as commission creates a salary for life."

A major player in the domestic and international banking sector, Banco Safra S.A. is the sixth-largest bank by assets and continues to spearhead innovation.

Energy sector powers ahead

Energy is one of Brazil's most important industrial sectors with the country using its vast natural resources and excellent climate to generate up to 90% of its electricity from renewable sources such





as hydro-electric, wind and solar power, as well as biofuels.

According to Mines and Energy Minister, Márcio Pereira Zimmermann, the nation is benefiting from its extensive experience of using ethanol produced by sugar cane, and its large network of hydro-electric plants located on its many rivers.

"Brazil generates between 80% and 90% of its power from renewable energies," states Minister Zimmermann. "The installation of hydro-electric plants has a great social impact on the surrounding region as it boosts the human development index and generates new jobs and infrastructure.

"FDI opportunities in this sector include the development of our significant wind power capacity, thermoelectric gas power plants, biofuels, plus energy transmission systems."

An industry giant with a presence in 27 countries and 75,000 employees, Petróleo Brasileiro S.A.—known as Petrobras—is a semi-public company that is pioneering the extraction from "pre-salt" oil fields—reserves located under a thick layer of salt.

"Petrobras will invest U.S.$220 billion by 2014," Minister Zimmermann adds. "We see the pre-salt reserves producing five million barrels in 2020, which will more than meet domestic demand and so we could start exporting."

With a vision to become the most admired power distributor in Brazil, Elektro supplies energy to millions of private and commercial customers living in São Paulo state and the surrounding region.

The award-winning company, which is an energy distribution subsidiary of Ashmore Energy International, is committed to sustainable development and environmentally-friendly technology.

From its modern headquarters in Campinas, Elektro is building a proud reputation for customer service excellence and exceptional standards of safety for its workforce and clients.

Elektro president, Carlos Ferreira, states: "We are focused on quality, safety and excellence and have won many national and international awards in recognition of our standards.

"Our future is bright as we have a world class workforce that is committed to the same goals as senior management. This alignment of management goals with the ambitions of every employee drives success and allows us to grow."

One of Brazil's leading commercial real estate investment and management companies, São Carlos Empreendimentos' real estate portfolio includes offices, distribution centers and stores.

Established in 1999 having enjoyed 14 years of success as a subsidiary of retail giant Lojas Americanas S.A., São Carlos' main focus is real estate located in the states of São Paulo and Rio de Janeiro.

The company is looking for new investors as it gears up to exploit the many opportunities that will be created over the next six years by the hosting of the soccer World Cup and Olympic Games.

CEO Rolando Mifano states: "São Carlos has a portfolio of 37 properties with a market value of U.S.$950 million. We purchase buildings that need improving, carry out the required works and rent them to corporations. We sell them when they are considered mature.

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"Most international real estate investors have invested here via partnerships with local firms and it is the right approach as they benefit from the knowledge and expertise of local market professionals."

Innovative ICT Systems

Brazil's Information and Communications Technology (ICT) industry is the continent's best due to major private sector investment in fixed line, mobile, Internet and digital TV networks and systems.

The Brazilian Association of Information Technology and Communication Companies (Brasscom) represents the main ICT and business process outsourcing (BPO) firms active in the country.

"Brazil has the world's eighth largest internal ICT in the world yet it only exported U.S.$2.2 billion in offshore outsourcing services in 2008," says Brasscom president, Antonio Gil. "The challenge is to turn Brazil into one of the world's three greatest ICT centers, on a par with India and China."

Formed in 1991, Grupo TBA is a leading provider of software and IT services to public and private sector clients in Brazil's political and economic hubs: Brasília, São Paulo, Rio de Janeiro and Belo Horizonte.

The company is one of the top three distributors of Microsoft software in Latin America and the region's leading seller of Oracle products, factors that have seen revenues jump by more than a third in each of the last two years.

Grupo TBA founder and CEO, Cristina Boner, states: "We are focused on diversification and organic growth that could involve mergers and acquisitions of smaller specialist companies to complement our current service offering."

Founded in 1994 in the capital of Brazil, Instituto de Educação Superior de Brasília (IESB) is a top provider of further education with thousands of young people attending three modern campuses.

Students can study a range of subjects at graduate and post-graduate level, including subjects such as journalism, public relations, marketing, psychology, fashion design, advertising and gastronomy at its excellent culinary school.

"We want to create leaders who make a difference in society," says IESB general director, Eda Machado de Souza. "We are working to become a university center to



"Brazil's robust economy has made a quick recovery from last year's global slump. Add to that the potential of petroleum sub-salt reserves, the 2014 FIFA World Cup and the 2016 Summer Olympics, and you have a vast window of opportunity for infrastructure investments nationwide.

The inovative name in IT, agribusiness, energy and seaport infrastructure, TBA is ready to join forces with global partners wishing to see substantial returns on their investment in Brazil."

Cristina Boner
Founder and CEO of TBA Group

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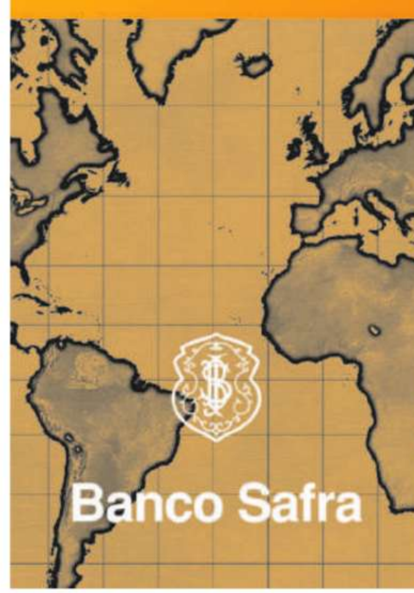
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Banco Safra. The safety offered by Brazil's sixth-largest private bank by assets and the returns provided by an institution with US$ 36.8 billion worth of clients' funds.

Many people think a big bank is a synonym for red tape. What people don't know is that, first and foremost, a big bank must be agile and efficient. It must anticipate economic crises and instability. It must create new technologies. This is the only way it can combine attractive returns and safety for its clients. This is how Banco Safra has become Brazil's sixth-largest private bank by consolidated assets, which total US$ 40.8 billion(1), and one of the most important fund managers in Brazil, with US$ 36.8 billion worth of clients' funds(2). Come to Banco Safra. In a globalized economy, it's not enough to be one of the largest banks. You must also be the best.

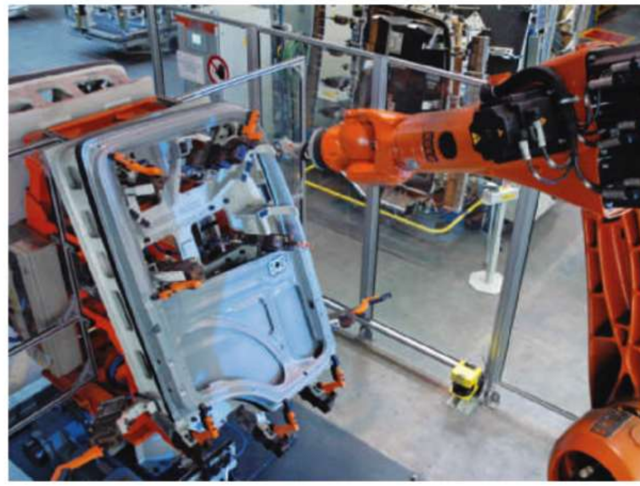
(1) Source: Central Bank of Brazil: Top 50 Banks in Brazil by Total Assets - December 31, 2009.

(2) Total deposits, mutual funds, debentures - December 31, 2009.



Banco Safra


IESB, the best and most well-equipped Brazilian culinary school.


MAN's cutting-edge technology is tailored to the Brazilian market.

help our growth and international recognition. This will happen in the next few years."

The undisputed leader in its field, MAN Latin America is a leading maker of truck and bus chassis with its state-of-the-art plant in Resende, in Rio de Janeiro state, recently boosting annual capacity to 72,000 vehicles in response to soaring demand.

The dynamic company has headed the market for trucks weighing more than five tons since 2003 and, thanks to substantial investment and its highly trained workforce, is now the market leader for trucks weighing more than three tons.

At the cutting-edge of truck and bus design and innovation, MAN Latin America recently supplied three customers with the first trucks to run on 100% bio-diesel. The firm, which has consolidated operations with Volkswagen Trucks and Buses, recently won a contract for 427 armored trucks chassis as its expansion drive gathers speed. MAN Latin America and its support service providers employ 5,400 people.

"Brazil has left the global economic crisis behind and will continue to grow. We are confident other countries in Latin America will see further growth which MAN will benefit from," says Antonio Roberto Cortes, president and CEO of MAN Latin America.

Cortes, who will oversee the launch of the first TGX and TGS heavy truck ranges later this year, lists his company's competitive advantages as its local engineering base, unique production concept, excellent dealer network and after-sales support, and years of working closely with Volkswagen.

Cortes reveals trucks made for the Latin American market need specialist features to cope with local driving conditions. They include special windshields for the sunny climate, greater security measures like covered cab steps, chassis that can withstand unpaved roads and efficient engines powered by biofuels.

"Our five year investment plan is worth U.S.$580 million and we are implementing a new production line for the MAN truck and bus product as well as adding one shift," says Cortes. "But this is just the beginning, because with the soccer World Cup and the Olympics, plus the pre-salt discovery, there will be a lot of demand for trucks and buses so we need to be prepared for this challenge."

A leading figure in the transport and logistics sector, BRL Worldwide Logistics Ltda caters to the demands of multinationals and smaller companies in Brazil and abroad.

The firm's extensive network of agents and partners makes it a key supplier of transport and logistics services and it has a partnership with Washington D.C.-based Cavalier Logistics.


Jean Stenio, President, BRL Worldwide Logistics Ltda.

BRL's operations include air and ocean transportation, customs clearance, documentation, shipping and post-shipping follow up. The company performed all the Brazilian logistics operations of the U.S. government during the Bush administration.

"Initially, we focused our efforts on Brazilian companies that demanded personal, tailor-made, high-quality solutions in line with international standards," says BRL president, Jean Stenio. "We don't try to compete with major couriers; by being smaller, we are fast and efficient. Our transparency with the customer is a major advantage; if there is a problem, we communicate it to the client and tell them how we will solve it."



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MAN Latin America will blend the vast knowledge of 30 markets in two continents that Volkswagen Trucks and Buses possesses with the accumulated experience of MAN – a German company dating back more than 250 years as a global leader in the transportation sector.

With the upcoming arrival of MAN models, the customers will have access to technological innovations as well as a product portfolio. Apart from that, nothing else changes. MAN Latin America will stay focused on the distinctive denominator that guided Volkswagen Trucks in its rapid conquest of Brazilian market leadership: customer care.

In short, what was already excellent just got better. Welcome to MAN Latin America.

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MAN



Petrobras is more than an oil company.



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Petrobras is renowned around the world for its technology and leadership in deep and ultra-deepwater exploration and production. It's also a pioneer in biofuels and makes continuous investments in alternative energy sources. But, more importantly, Petrobras is committed to social development, citizenship, the environment and sustainability. In addition, it fosters culture and the arts. If the future is a challenge, Petrobras is ready for it.

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How business casual led to the bondage collar Page 94

Etc.

The latest result of the recession? Condiment mania! Page 96



Why Ballers Go Bust

By Paul Wachter



Scottie Pippen
Lost $120 million in bad investments



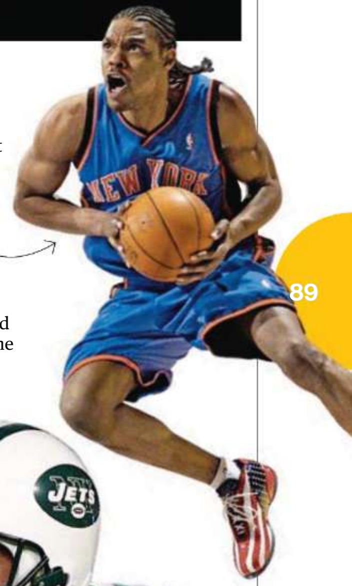
Derrick Coleman
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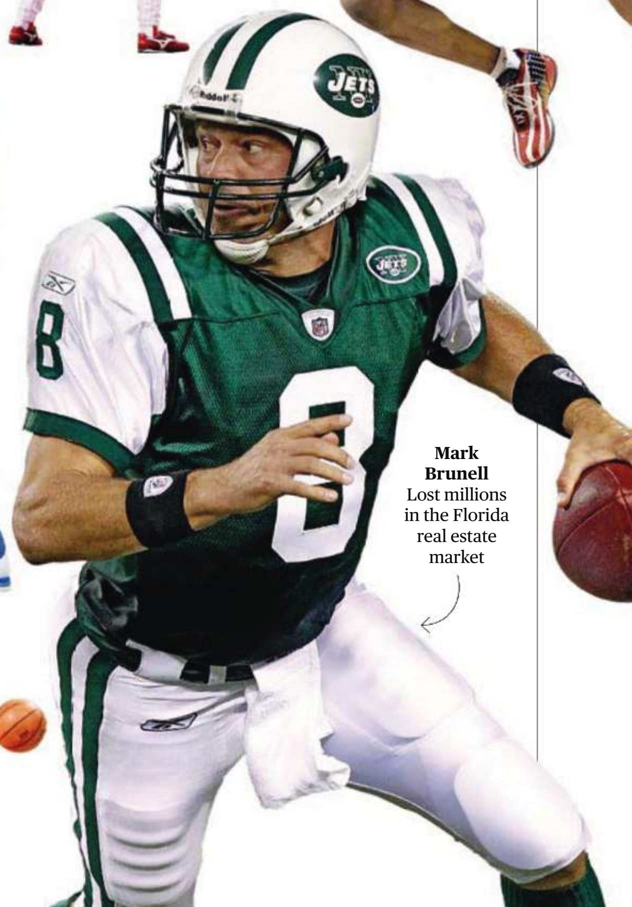
Antoine Walker
Filed for bankruptcy protection after a $110 million career



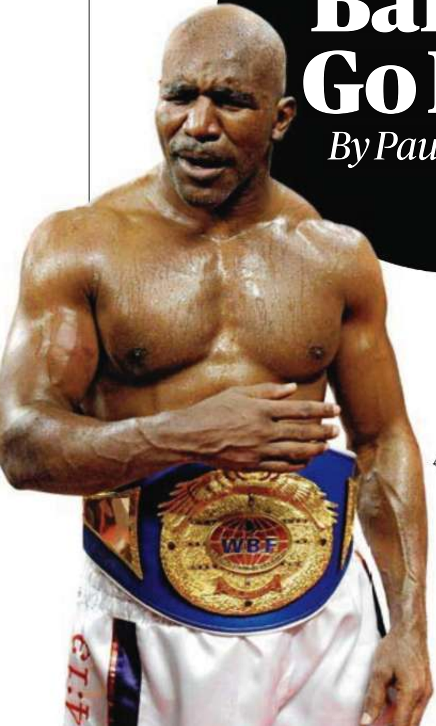
Lenny Dykstra
Never seemed like a magazine publisher



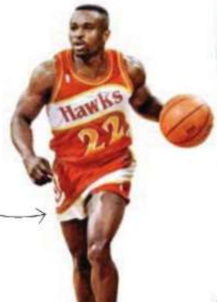
Latrell Sprewell
Shouldn't have bought that yacht



Mark Brunell
Lost millions in the Florida real estate market



Evander Holyfield
Blew more than $200 million



Rumeal Robinson
Potentially facing 30 years behind bars

Etc. Broke Athletes

After the first day of his fraud trial on Aug. 30, Rumeal Robinson was chewing on a steak at a downtown Des Moines restaurant. Dressed in an olive suit, he wore a Seiko watch bearing the logo of his alma mater, the University of Michigan. Back in 1989, Robinson gave the Wolverines their only national basketball championship, nailing two free throws in the final seconds to edge Seton Hall by a point. While he never blossomed into a National Basketball Assn. star, the former first-round draft pick earned about $5 million during six years in the league and hundreds of thousands more playing overseas. Now, according to prosecutors, it's all gone—and as he ran through the money, they allege, Robinson committed 11 counts of financial fraud, including a kickback to his banker related to a failed real estate deal.

While other former NBA players have squandered their riches—bigger earners such as former Celtics All-Star Antoine Walker and Nets 1990 top draft pick Derrick Coleman each filed for bankruptcy protection in the past 12 months—none are looking at 30 years in prison. That's what Robinson, 43, could get if he's found guilty. What rankles him, though, is that the entire defense strategy of his lawyer, J. Keith Rigg, rested on Robinson's incompetence as a businessman. "For all his good intentions, Rumeal doesn't have a background in finance, business, or development," Rigg told the jury. "Mr. Robinson doesn't know what he's doing."

If that's the case, he's not alone. An alarming number of professional athletes suffer financial ruin late in their careers or after they've retired. Walker and Coleman lost their earnings in unwise real estate investments. New York Jets backup quarterback Mark Brunell's Florida property ventures landed him in bankruptcy court this spring with $24.7 million in liabilities and $5.5 million in assets—which may explain why, at 40, he's still playing pro football. Ex-Philadelphia Phillies center fielder Lenny Dykstra tried to create a one-man financial empire—including the ill-fated *Players Club* magazine—built on bad checks. He sold off his World Series ring to pay creditors.

Why do athletes go broke? "Lifestyle, family, or bad business ventures," says an adviser to the pros

From 6 percent to 8 percent of NBA players end up broke, estimates National Basketball Players Assn. spokesman Dan Wasserman. *Sports Illustrated*, however, has reported that 60 percent are in serious financial trouble within five years of retirement. "Usually it's one or a combination of three things," says Joseph Geier, a financial adviser for New York Yankees first baseman Mark Teixeira and other athletes. "Lifestyle, family, or bad business ventures." For some it's all three. Walker earned more than $110 million in the NBA, but he supported a large entourage and gambled recklessly. He also started a venture capital firm and real estate company that both hemorrhaged money. Coleman, who made more than $87 million playing basketball, picked a bad time to invest in Detroit real estate. Since both men's earning curves peaked in their mid-20s, it was increasingly difficult for either to recoup such losses with each passing year.

To avoid this fate, the NBA and the NBPA cohost a three-day seminar on financial management for incoming rookies each summer. (Professional football and baseball have similar programs.) "It's

How To Succeed in Business... Without Ending Up Crying

Sports stardom doesn't always equate to business success. A scorecard of athletes who have won in business—and others who've lost.

Winner



Magic Johnson

Although he failed as a talk show host, the L.A. Lakers minority owner—with an estimated net worth of $500 million—helms a nationwide movie theater chain and a movie studio. Last month his company announced it would take part in a $1.5 billion development project—in Boston, no less.

Loser



Raghib "Rocket" Ismail

In 1991 he passed on the NFL to play in the Canadian Football League for a then-unprecedented $18.2 million. He eventually retired from the NFL in 2001, and subsequently lost millions on a series of bad investments including a religious movie, a music company, and calligraphy shops.

Winner



Jamal Mashburn

The former NBA All-Star earned more than $75 million during a 13-year career. Currently an ESPN analyst, he also owns 34 Outback Steakhouse franchises, 37 Papa John's locations, and several car dealerships in Kentucky, where he starred as a college player.

Loser



Scottie Pippen

According to Yahoo! Sports, Michael Jordan's sidekick lost his career earnings of $120 million in bad investments. After being awarded $2 million in a lawsuit against two lawyers for mishandling his purchase of a jet, Pippen exited the courtroom in tears.

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Clinching the 1989 NCAA championship for the University of Michigan

Finance 101," says Mike Bantom, the NBA's senior vice-president of player development. The emphasis is on saving, spending habits, and investing. "You get your paycheck, but you don't get any instructions with it," says Los Angeles Clipper star Baron Davis. And there's social pressure to maintain a luxurious lifestyle, says former Sacramento Kings forward Lawrence Funderburke. "Chris Webber and Mike Bibby used to make fun of me because I drove the same car to practice for two years," he says.

Robinson insists he lived modestly for someone whose first contract in 1990 brought him, before taxes and agent fees, $4.7 million. "I bought a Nissan 300ZX and a penthouse apartment in Atlanta," he says. "They were my only big purchases." His brother, Donald Barrows, says Robinson blew money partying at strip clubs and even paid strippers to undress and clean his apartment. Robinson denies this: "Doesn't Don know that when you're in the NBA you don't need to pay strippers?"

Whether or not he paid them, it wasn't the strippers who threatened Robinson's future. Between 2004 and 2005 he received more than $700,000 in loans from Community State Bank in Des Moines, ostensibly for a development project in his native Jamaica. In exchange, Robinson sent $100,000 directly to the loan officer, Brian Williams, who has himself pleaded guilty to conspiracy to commit bank fraud. Meanwhile, Robinson hasn't paid back a dime. In their investigation, federal prosecutors found bank statements showing that Robinson spent the money on luxury cars, a Miami condo, and designer clothes. The property in Jamaica that Robinson claimed to be developing is controlled by a Florida investment company that says it never dealt with him.

Lenny Dykstra sold off his World Series ring to pay off his creditors

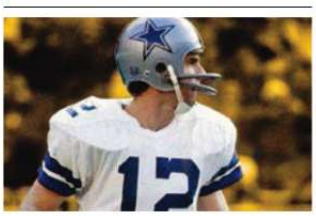
Most Americans would be happy with a nest egg of a couple of million dollars—the amount Robinson pocketed during his career. "But even if [an athlete] has invested wisely and has tons of money in the bank, there's still the question of what to do when you wake up in the morning, which is why I think so many are drawn to business," says George Foster, a professor at Stanford's NBA Business Opportunities Program, which provides off-season multiday seminars to NBA players interested in business. "Virtually no ex-pro athlete wants to work a regular nine-to-five job."

There are exceptions. After retiring from the NBA in 2005, Funderburke earned his MBA and opened a personal finance business. Dan Majerle, an All-Star for the Phoenix Suns, is now not only an assistant coach with the team but also owns several eponymous restaurants. "I'm closely involved with the day-to-day business," Majerle says. "And I also made sure I didn't expose myself to risk that I couldn't afford. I put up a small amount of money to start the first restaurant, and then, when it was successful, I bought out other investors." Baron Davis—signed to a five-year, $65 million contract with the Clippers—has taken a similar approach to the production company he co-founded, Verso Entertainment. "What I've tried to do is save as much of my salary as possible and use my endorsement money to live off and invest," he says.

It's a prudent financial strategy, but for every Davis or Funderburke there's a Walker or Coleman. After briefly playing professionally in Puerto Rico, Walker recently failed in his bid to make an NBA comeback. For Coleman, drafted the same year as Robinson, there was no such option. Perhaps the only way to ensure against such flameouts would be to put a big chunk of players' salaries into escrow each year, says Dan Fegan, an agent who represents this year's top draft pick, John Wall. That's unlikely to happen, he adds. The NBA can tell its players what kinds of clothes to wear on the bench, but it can't tell them what to do with their money. And despite the cautionary tales, "Players still think, 'That'll never happen to me,' " says Funderburke. "And things could get worse in the near future," he says. There may be a lockout after this season—a strong possibility for the National Football League as well—and it remains unclear if the Bush tax cuts for the wealthy will be renewed.

For his part, Robinson insists he just hasn't caught his big break. While he claims he still has money—"I have a billion dollars in bonds," he says, straight-faced—he skips lunch before his trial hearing and decides to order steak for dinner after finding out *Bloomberg Businessweek* is footing the bill. Afterward, he walks a few blocks and phones a friend for a ride back to his hotel. Ⓑ

▸ ***Winner***



Roger Staubach

In 1977, two years shy of retiring from the Dallas Cowboys, Staubach launched his real estate business, Staubach Co., after spending off-seasons working for a real estate firm. He sold his company to commercial real estate giant Jones Lang LaSalle in 2008 for $613 million.

▸ ***Loser***



Latrell Sprewell

In 2004 the talented malcontent turned down a $21 million deal—and never played again. In business, he helped popularize spinning hubcaps, but poor management led to the repossession of his yacht and the foreclosure of two homes.

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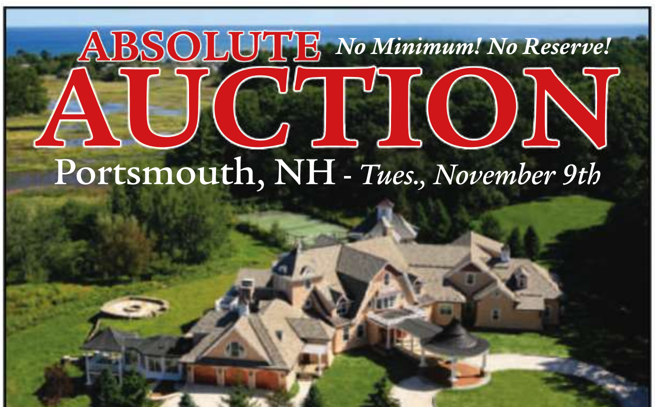
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According to a recent study, only 34 percent of bosses permit casual office dress each day



The Tragic Decline Of Business Casual

Terrible dressers are running wild in the office. Now their bosses are fighting back. *By Eric Spitznagel*

Remember the late 1990s and early 2000s, when "casual Friday" was a naughty thrill? How innocent we were. In the past decade those seemingly harmless polo shirts and khakis have spawned a five-day sartorial office free-for-all that's led to low-cut jeans and "tramp stamp" tatoos. According to a 2007 Gallup poll, the most recent data available, 43 percent of workers said they regularly wore casual business attire at the office, up from 32 percent in 2002. Even scarier, the lax precedent has allowed them to make their own decisions about what's acceptable or, worse, cool.

The C-suite is striking back. A survey released in June by the Society for Human Resource Management found that only 34 percent of bosses officially permitted casual dress among employees every day–a dramatic drop from 53 percent in 2002. Some executives are hiring image consultants and fashion experts to crack down on everything from muumuus to *Little House On the Prairie*-style pioneer dresses. "American society has become so ridiculously casual," says Clinton Kelly, co-host of the Learning Channel's *What Not to Wear*. The problem, he suggests, may be the lack of office fashion role models. "Outrageous people are getting the most attention now," he says. "Kids coming out of college are watching Lady Gaga on YouTube. They don't understand that Lady Gaga is selling albums, and they're in accounting. A meat dress just doesn't fly at the office."

Kids "don't understand that Lady Gaga is selling albums, and they're in accounting"

Popularized in Silicon Valley, the casual office look has always had noble intentions. "At Google we know that being successful has little to do with what an employee is wearing," says Jordan Newman, a spokesman for the company. "We believe one can be serious and productive without a suit." That may be the case for engineers dealing with complicated algorithms. However, professional image coach Lizandra Vega remembers meeting a male worker at the New York staffing firm where she's a managing partner. He arrived for a meeting in thin white cotton slacks–and no underwear. "He was," she recalls, "hanging *loose*."

ILLUSTRATION BY MARCOS CHIN

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Even upper management isn't immune to terrible dress habits. Diane Gottsman, owner of the Protocol School of Texas, recalls teaching a business fashion workshop in Houston last year during which she met an executive "wearing a straw paperboy hat pulled sideways," she says. "He had on suspenders and black-and-white spectator shoes. He asked, 'What do you think of my look?' " Gottsman tried to be diplomatic, suggesting he take off his hat indoors. "He couldn't do that," she says. "The hat helped him with his 'swagga.' "

Workers may not like rules, but some need them. A 2002 survey by the recently shuttered department-store chain Mervyns revealed that 90 percent of office workers didn't know the difference between formal business attire, business casual, and just plain casual. However, companies such as General Electric force them to make these distinctions every day by asking that they "use good, professional judgment," as GE puts it. Ginger Burr, president of Total Image Consultants in Lynn, Mass., recalls a fashion workshop she conducted with a national bank. "We were talking about sandals," she remembers. "There seemed to be a consensus that sandals shouldn't be worn. Then this beautifully dressed female executive walked in wearing sandals, and said, 'We should be able to wear *nice* sandals.' When you get into personal taste, that's where it becomes tricky."

Sandy Dumont, an image consultant from Norfolk, Va., believes the biggest challenge in overhauling an office worker's wardrobe is avoiding hurt feelings. Her suggestion: Hire a professional image consultant. She was brought in to help a female employee at Rolex who was offending an executive with her "klutzy" footwear—which turned out to be orthopedic shoes. ("She had a slightly deformed foot," says Dumont.) Fearing that a confrontation would offend the woman, Dumont led her on a guided shoe-shopping spree on the company's dime.

Those accustomed to personalized business style aren't taking these changes lightly. "The uniformity of dress serves the current American business model by pressing individuals into the service of the corporate person," says Jack Tuckner, a New York employment attorney who briefly represented Debrahlee Lorenzana, a Citibank employee fired earlier this year for wearing provocative clothing. "It's a largely paramilitary model that eschews independent thinkers," he says. In 2008, Tuckner was sued by a former colleague for allegedly wearing a "bondage collar" at the office. Tuckner denies the allegations. "As a fastidious dresser myself," he says, "I'd be excessively worried about unsightly neckline bulges caused by the lock."

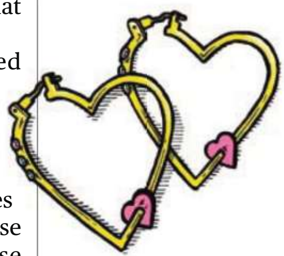
In Britain the concept of business casual is being taken to extremes. *The Naked Office*, a reality TV series that made its debut in May, asked employees at several businesses to show up for work naked, ostensibly in an attempt to "explore whether flashing the flesh is the ultimate office equalizer"—and boost ratings. Seven Suphi, a behavioral change specialist and author of *More Than Men and Make-Up*, took part as an expert presenter on the show and says the experiment "had spectacular business results. One business secured their largest deal to date. Another is doing in a month what they previously did in a year." Let us ponder why.

In America, such a radical redefinition of office norms seems unlikely. Carolyn Hawkins, spokeswoman for the American Association of Nude Recreation in Kissimmee, Fla., says even her staff rarely comes to work in the buff. "The AANR's association headquarters is located in a downtown strip mall—no pun intended—with a storefront window," she says. "As practicality and sensitivity to our neighbors dictate, we dress for the workplace. When we return home in the evening we remove the stresses of the workday world by removing our clothes." For the moment, business casual appears to be in no danger of becoming no-pants-casual—but it's still enough to make you pine for the days of khakis and polos. Ⓑ

One image consultant recently met with a man in white linen slacks who was "hanging *loose*"

The Top Five Office Fashion Faux Pas

According to image consultants and office fashion experts, here are the most common workplace style sins. Anything sound familiar?



1 "Hooker" Earrings

"Long, dangly earrings are street market and cheap," says image consultant Sandy Dumont. Unless you're going for a call girl look, you might want to wear something more conservative.

2 Chest Plumes

How many shirt buttons should you unbutton? Business fashion expert Diane Gottsman's rule: Stop when you can see chest hair. The reverse is also true: Shirts that are tight around the neck look like "your little brother's castoffs."





3 Exposed Bra Straps

According to image consultant Ginger Burr, bra straps aren't attractive enough to be part of an outfit. Do your colleagues a favor, she suggests: Keep the straps under wraps.



4 Tattoos

Gottsman has no problem if you've got a scorpion tattoo on your neck. Just hide it—or else "you're not somebody I want doing my taxes."



5 Toes

Image coach Lizandra Vega's pet peeve is open-toe shoes: "Toes are a kind-of cleavage. I don't care if you have a nice pedicure. Keep toes hidden!"

ILLUSTRATIONS BY WALTER NEWTON



More than 320 "table sauces" have been introduced in 2010, according to Mintel



Spreading the Love

During the recession, the golden age of condiments has dawned.

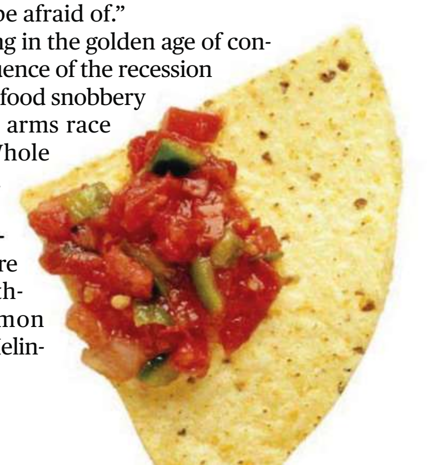
By David Sax

When President Barack Obama and Vice-President Joe Biden walked into Ray's Hell Burger in Arlington, Va., last year, they weren't just grabbing a greasy lunch. To hear some tell it, their choice of condiments revealed their souls. Biden got his burger with Swiss cheese, jalapeños, and ketchup while Obama asked for one with cheddar and Dijon mustard. Yes, *Dijon*. Viewing this condiment preference as a sign of elitism, conservative pundits attacked. Fox News' Sean Hannity decried "President Poupon," and bloggers warned that Obama was hell-bent on colonizing the American palate with subversive foreign flavors.

They manned the ramparts 20 years too late. Dijon mustard, it turns out, is now as American as freedom fries. "Dijon is actually outpacing the overall mustard category," says Justin Parnell, brand manager for Grey Poupon, owned by Kraft Foods, which makes its mustard entirely from North American ingredients. According to Chicago-based research firm SymphonyIRI Group, Grey Poupon is the second most popular mustard in America—and growing. In July 2010, sales were estimated at $76 million, up 7 percent from the previous July. "Back in the early '80s, Dijon was a sign of having real aspirational tastes," says David Kamp, author of *The United States of Arugula*. "Now it's entirely assimilated. That's the best of American food curiosity. At first it's considered too elitist, and then everyone says there's nothing to be afraid of."

Driven by 18- to 34-year-olds, the U.S. condiment market will swell to $7 billion by 2015

We are now living in the golden age of condiments. The confluence of the recession and our ubiquitous food snobbery has touched off an arms race on shelves from Whole Foods to Wal-Mart. Where there was once merely Gulden's and Heinz, there is now Robert Rothschild Farm's Lemon Wasabi Sauce and Melin-



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The U.S. condiment market is currently valued at $5.6 billion

da's banana ketchup. With budget-conscious consumers more likely to eat at home, a decade of exposure to fine dining and ethnic flavors—and *Iron Chef* reruns—has created a need for spreadable flavors at affordable prices. Condiment sales grew 9.4 percent from 2007 to 2009, becoming the second largest category in the specialty foods market behind the perennial stalwart, cheese. "Condiments are probably the biggest rotation of new products we have," says Mike McMahon, food buyer for Bristol Farms, a chain of 14 gourmet grocery stores in California. "There's always new flavor profiles, new diets, international influences, and ideas. The sky's the limit!" Chicago-based market research firm Mintel International Group notes that 36 mayonnaises have already entered the market this year—nearly three times as many as in all of 2009.

Condiment mania has now gone mainstream. Mintel values the U.S. market at $5.6 billion. Driven by its core audience, 18- to 34-year-olds, that market will swell to $7 billion by 2015, Mintel anticipates, as new whole-grain mustards, spicy ketchups, fruit-flavored salsas, blended aiolis, chutneys, and hot sauces hit grocery aisles. Like Reaganomics, high-end condiments trickle down—from glass bottles in specialty shops to squeeze bottles in supermarkets. Most make their entrance in the market at the biannual Fancy Food Show, which bestows the equivalent of an Oscar on the best branded spreadable sandwich toppings. Last July, Dulcet Cuisine's Mild Indian Curry Ketchup took home the condiment gold medal; the Oregon company's Moroccan Mustard nabbed silver. "A flavor will become popular, and other smaller companies will make that same flavor for their own products," explains Ron Tanner, spokesman for the National Association for the Specialty Food Trade. "Larger companies such as Kraft will then notice it and keep an eye on sales. Once big companies see 10 to 20 small producers doing this, they'll pick it up." On average, Tanner says, it takes three to five years for a condiment to go from niche product to mass market. "When you look at the extra cost per serving," says Tanner, "it's not very much at all. It's not like you're buying smoked salmon or caviar."

"It's like fashion. We're the H&M of condiments," says spreadable toppings scion Christopher Woeber

One company on the front lines is Springfield (Ohio)-based Woeber's, a family business best known for yellow and spicy brown mustards. Now enjoying a Pabst Blue Ribbon-like renaissance, the 105-year-old mustard maker has expanded by 50 percent with flavors such as jalapeño, cranberry, and wasabi. It has launched a line of organic mustards and another of premium mustards—which it sells in glass jars—and acquired such beloved regional brands as New Jersey's Mr. Mustard.



This April, Woeber's also launched a line of the latest spreadable craze: flavored mayonnaises. Called Mayo Gourmet, it comes in varieties such as Kickin' Buffalo, Toasted Garlic, and Cool Dill. "I would say it's probably double or triple our expectations," says condiment scion Christopher Woeber, the company's operations manager and great-grandson of its founder. "Flavored mayo is fairly new, so we expected some mixed response. But it's been positive almost all across the board."

Woeber's private-label operation, which makes and packages condiments for other brands or retailers, has grown to 60 percent of its business. Private labels now make up nearly one-quarter of the U.S. condiment market and are growing faster than any other segment, according to Mintel. "People want cheaper, more specialized gourmet products," says Woeber. "It's like fashion. We're the H&M of condiments."

The current craze doesn't sit well with some condiment purists. Barry Levenson, curator of the National Mustard Museum in Middleton, Wis., sees promise in newly released blue cheese and raspberry mustards. However, he draws the line at chocolate mustard. "I can't see that going into grocery stores," he says. "It's just not going to happen." Let's give it three to five years. **B**

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Invest in



Making Profits By Following the Prophet

Nicholas Kaiser manages $2.7 billion in mutual fund assets that adhere to Sharia law

Investing according to Sharia, the Islamic law that covers topics ranging from crime to economics to hygiene, is like dealing with any client who has rules: You follow them. However, the rules are strict, and they differ all over the world. In the 1990s the performance of our Sharia funds tended to be in the middle of the pack because the U.S. was shifting from industrial to financial businesses and we can't own financial stocks. Because of that, though, we've done better over the past decade.

I manage three mutual funds according to Sharia–Amana Growth, Amana Income, and Amana Developing World–that steer clear of companies selling alcohol, pornography, tobacco, gambling, and similar vices. We also can't invest in companies carrying too much debt and that profit from charging interest. [Debt must be less than 33 percent of a company's market capitalization for it to be in the fund.] We tend to be heavily invested in low-debt commodity stocks. The commodity business is cyclical, and banks tend not to loan cyclical businesses a lot of money, since earnings can evaporate.

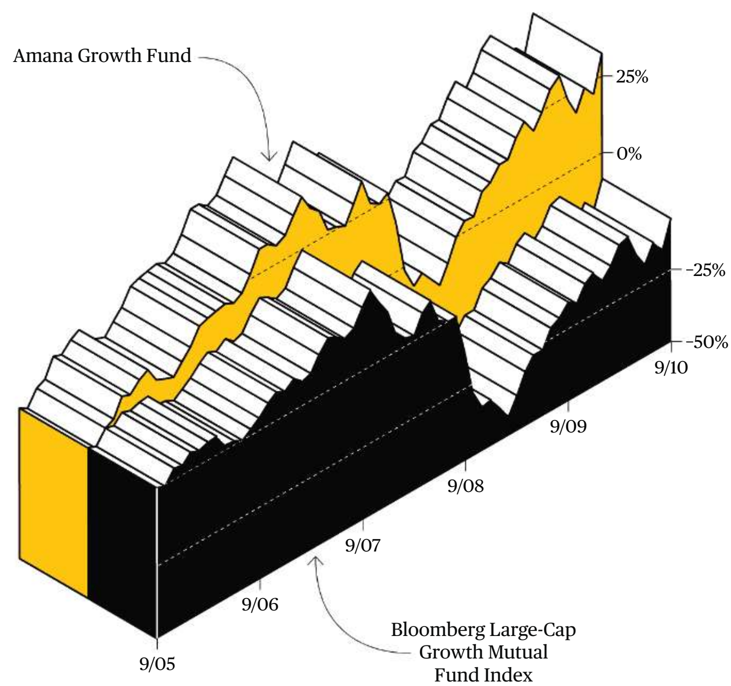
One of our main themes is China–how to capitalize on that growth and the business of their suppliers. A favorite stock is BHP Billiton, the Australian mining giant that's a major supplier to China. BHP is attempting to acquire the Canadian fertilizer company PotashCorp of Saskatchewan. It made a lowball offer of 130 a share, but so far no one has beat it. Even if the bid goes to 160 a share, it's a great value for BHP. Over time, potash will become a very valuable commodity. PotashCorp is 2.5 percent of the growth fund. To pay for the deal, BHP has agreed to borrow $43 billion; we'll have to reevaluate BHP because of the debt.

Canada has been a good market for us, too. Teck Resources is a mining company we like with gold, coal, copper, and other resource businesses. It dropped to a low of 3 a share in 2008 from a peak of about 52 in 2007. It paid for some coal mines at the top of the market, and people thought management couldn't make it work. They did, and it's now trading in the low 40s. We also like Canadian National, the most profitable and productive North American railroad. It has an excellent network, and it's certain to generate more free cash flow.

We don't just invest in Canada and resource companies. We also like Chile's LAN Airlines. LAN, a passenger and cargo airline, recently announced a merger with Brazil's TAM airline. Its stock is up 76 percent this year. It may be fairly valued today, but I'm looking longer term. It's a successful, profitable airline that will create the largest carrier in South America, which is a bigger growth market than North America. And the former chief executive of LAN is now the President of Chile. He was just in Qatar talking to the airport authorities about how Chile needs landing rights there. They said, "We can do that, Mr. President." —*As told to Christopher Farrell*

LOW-DEBT PICKS HAVE PAID OFF

Kaiser's $1.7 billion Amana Growth fund has outperformed its benchmark



DATA: BLOOMBERG

The merger of Chile's LAN Airlines with Brazil's TAM will create the largest carrier in South America

The Stats: Nicholas Kaiser is chairman of Saturna Capital in Bellingham, Wash. His Amana Income has had an average annual return of 8.3 percent since 1986, while his Amana Growth has had an average return of 10.1 percent since 1994. Kaiser's Amana Developing World is up 7 percent since September 2009.

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Rebooting The Boob Tube

The Apple TV is the company's boldest foray yet into the living room. *By Rich Jaroslovsky*

There's something mysterious about the new Apple TV—a black hockey puck-size box that connects to your hi-def set. It's from Apple, so it *must* be cool, right? What does it do, though? The answer: Some entertaining stuff right now, and maybe a lot more down the line.

Apple has been nibbling around the edges of the living room for years with Apple TV, originally a set-top box that stored and played purchased movies and that Chairman Steve Jobs called a "hobby." The new Apple TV has been shrunk to a quarter of its former size, the price has been slashed from $229 to $99, and, most important, it no longer includes a hard disk to store video. Apple TV is now built around its ability to use your home Wi-Fi network to stream high-definition movies and shows, photos, and music—from online sources or your computer—to your television.

Setup is easy: Connect it to your set via an HDMI cable and plug in the power. Then just follow the on-screen instructions to introduce it to your Wi-Fi network and iTunes Music Store account. Instead of using Apple TV's included remote control to key in your password letter by letter on the big screen, download Apple's free Remote app for your iPad, iPhone, or iPod Touch, and enter your text from there. (It's particularly useful if your user name is 11 letters long.)

With no way to store purchased content on the new Apple TV, you'll probably use it mostly to view movies and shows rented from the iTunes Store. The movie selection has thousands of HD titles starting at $3.99. The TV selection, however, is limited: The only major U.S. networks signed on to Apple's 99¢-an-episode menu are Fox and ABC. (Jobs is the largest shareholder in Walt Disney, ABC's owner.) Once you rent something, you have 30 days to start watching it, then 24 hours (for movies) or 48 hours (for TV shows) to finish. There are a few other programming sources. Netflix customers can get access to its Watch Instantly movies and TV shows straight from the device; and Apple TV can also tap into YouTube videos, podcasts, and Internet radio. It even makes it easy to view movies and photos stored on your computer.

APPLE TV

The device ($99) allows users to stream movies, television shows, radio, music, and pictures over a Wi-Fi connection

Apple TV's 720p-quality video provides a consistently crisp, smooth picture, with none of the stuttering that sometimes mars streamed content. The one blemish I encountered was that the device occasionally grossly overstated how long it would take to begin watching a movie after selecting it. In one case it gave me an estimated wait time of 371 minutes, when the actual delay was less than four minutes. Other movies began playing in a minute or two. Apple claims momentary glitches in my Internet service might have been to blame for the erroneous warnings.

This being Apple, more slick functions are on the way. After a software update promised for next month, you'll be able to stream video to the Apple TV from an iPad, iPhone, or iPod Touch. You can begin a movie on a mobile device, walk into your home, and—*voilà*—have it appear on the big screen in your den. (Unfortunately, the process won't work in reverse.)

Apple TV may turn out to be a Trojan Horse—a deceptively simple gadget that, once in the home, expands its functionality until it takes control of everything. Or it may prove to be the first step toward an Apple-branded television set. Either way, it's no longer just a hobby. B

IPhone users who don't want to use the remote can try Apple's free Remote app



You may not need them, but the Apple TV has connections for optical audio and Ethernet

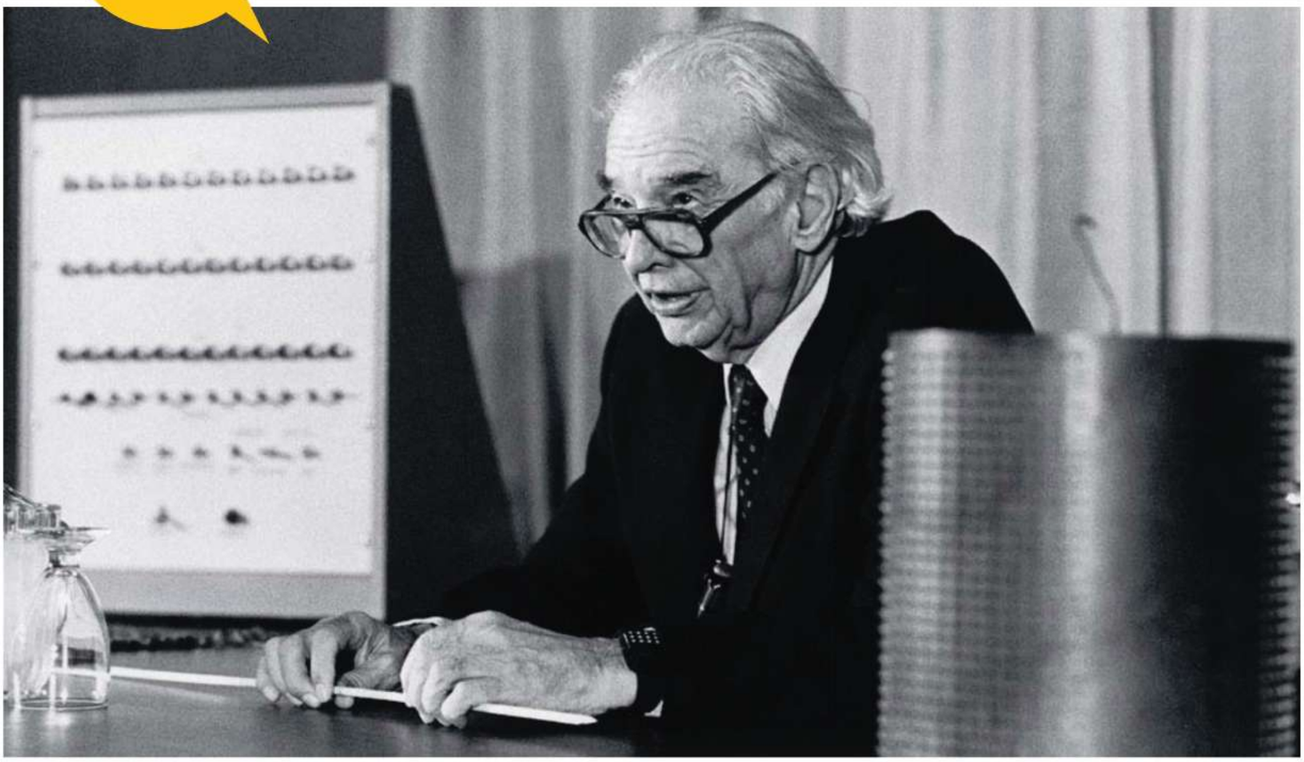
The only major networks signed on to the device are ABC and Fox

PHOTOGRAPH BY PLAMEN PETKOV FOR BLOOMBERG BUSINESSWEEK

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Atanasoff sketched his design for the first computer on a cocktail napkin



TOP: BETTMANN/CORBIS

The Invisible Man

John Atanasoff built the world's first computer in the name of science—not simplicity. *By Michael Rosenwald*

One night a young physics professor named John Atanasoff got up from his dining room table and went for a drive along the Iowa back roads. "I was in such a mental state," he recalled dramatically, "that no resolution was possible." When he crossed into Illinois, though, Atanasoff spotted a roadside tavern. He went inside, ordered a bourbon and soda, took a sip, and then, with the crispness of a Frank Capra scene, the moment he'd waited for his entire life revealed itself. The design of the world's first working computer flashed before his eyes. He jotted down the plan on a cocktail napkin. It was 1937.

In *The Man Who Invented the Computer*, author Jane Smiley—yes, *that* Jane Smiley—tells the story of Atanasoff and of the subsequent race to build the world's first computer with all the grace expected from a fine novelist. In the first of publisher Doubleday's series on innovators, Smiley benefits from a subject culled from fiction. Born to Bulgarian immigrants, Atanasoff grew up in tiny Brewster, Fla. As a child, he memorized the manual for his father's Model T Ford and wired his family's home for electricity. As he got older, he sought the attention of girls by teaching himself to crochet. He spoke often about nondecimal ways of counting and considered himself a precocious mathematician. He often got into fistfights. By the time he was in graduate school, he was known as the Mad Russian. When Smiley quotes Atanasoff as confessing that he had been "unhappy to an extreme degree" as he struggled with the design of a computing machine, it isn't difficult to understand why.

While earning his PhD at the University of Wisconsin at Madison, Atanasoff became sick of using a Monroe calculator—a typewriter-like device whose power was limited to solving simple equations. After landing a job teaching quantum mechanics at Iowa State University, he tinkered with existing calculators, including one created by IBM, to make them more powerful. With a graduate student named Clifford Berry and a $650 grant, he built a prototype of his computer, the ABC, in 1940.

Atanasoff's computer may have been, as Smiley attests, the most important invention of the 20th century. The race to get there first, amid



i

The Man Who Invented the Computer: The Biography of John Atanasoff, Digital Pioneer

By Jane Smiley, 256 pages, Doubleday. $25.95

the backdrop of war, is eerily similar to today's battle to control the Internet, albeit without the black hoodies and flip-flops. That's to say it was filled with greed, hubris, and deception—and also genius, luck, and a cast of colorful characters. One of Atanasoff's competitors, the brilliant Nazi code breaker Alan Turing, was so focused on his work he forgot Christmas arrived every year on the same day. Another, Konrad Zuse, worked on his machine in nearly complete isolation in Berlin, which made his eventual creation of the Z3—the world's first programmable computer—that much more extraordinary. "Oddly enough," Smiley writes, "no inventor of the computer got rich off the invention, even though a few tried."

Never heard of Atanasoff? There's a reason. Having been called to work on government war programs, he wasn't able to patent his invention. Only in 1973, after a lengthy court battle, was he credited with being the inventor of the first digital computer, which was assembled in the basement of the Iowa State physics building. | The ABC (Atanasoff-Berry Computer) consisted of vacuum tubes and regenerative capacitor memory elements—capable of storing bits of data—that was 6 feet long and more than 3 feet tall, about the size of a souped-up Weber barbecue grill.

In our Jobsian era of apps, Atanasoff's story is a reminder of computing's original mission: to solve equations and problems that humans were incapable of handling themselves. Smiley notes that Atanasoff envisioned a machine much like the human brain, with regenerative, operation, and storage memory. As Atanasoff once wrote: "I had been forced to the conclusion that if I wanted a computer suited to the general needs of science and, in particular, suited to solving systems of linear equations, I would have to build it myself."

It was a noble purpose, and subsequently one wonders what Atanasoff would make of his invention's spawn—the Human Genome Project, new biotech drugs, and terrorist tracking software aside. However, the value the public and investors place on a computer—whether an iPad, Droid, |or BlackBerry—is inversely related to its size. As Steve Jobs has said over and over, the smaller computers become, the more "magical" they are in our lives. He has a point. Back then, it would have taken hundreds of Atanasoff machines to provide the computing muscle of 15 minutes on the iPhone. Not everyone has a basement with that kind of storage space. And maybe the young Atanasoff would have found more friends had he been on Facebook.

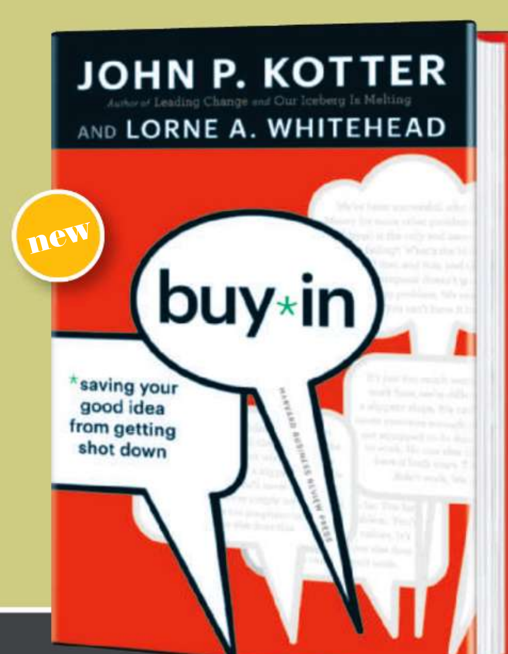
Yet as computers have gotten smaller, critics say, so have many of their objectives. Smartphones have become low-hanging fruit for software developers salivating at the chance to make a quick buck. Their development isn't only preoccupying the media, it's also dominating investment and venture capital dollars.

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Kleiner Perkins Caufield & Byers, the firm that helped launch Amazon.com and Google, recently started a $200 million funding effort for apps.

We're unwittingly headed toward something called lock-in. The more we use these tiny computers for tasks we've always done without gadgets, the further removed we'll become from real innovation. For all the pleasure and time-saving mechanisms these tiny computers afford, there is this disturbing iFact: They aren't solving any real problems. The single most purchased app on the iPhone, Angry Birds, allows players to sling digital birds at virtual pigs. Apple, once at the forefront of computing, is now, according to Jobs himself, a mobile device company—and who can blame it. Apple sold more than $7 billion worth of iPhones and iPads in the third quarter. Mac sales: $4.4 billion.

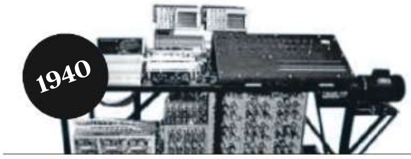
Fortunately, there are initiatives to push the new Atanasoffs in different directions. Web guru Tim O'Reilly is behind a program called Gov 2.0, an effort to get developers to improve government through apps. The U.S. Army recently held a contest for new apps, and winners included those dealing with disaster-relief aid, route calculators, and tools for young soldiers to understand the ranking system. Federal health officials are currently giving developers access to data on drugs and diseases.

All of this would likely please Atanasoff. However, apps that seek to innovate are still a long way from sexy. Earlier this year at TechCrunch Disrupt, a hacking event attended by some of the industry's sharpest computing minds, the most successful program to emerge was a smartphone app called GroupMe. It lets users create instant chat groups for trading private text messages—you know, instead of getting together for a beer. When Doubleday publishes the story of this generation of innovators, it'll probably be in an app and not even a book. B

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The Wayback Machines

The evolution of the computer, from the pursuit of science to Lode Runner



ABC

John Atanasoff, working with Iowa State University graduate student Clifford Berry, built his ABC machine with a memory design still used today. In 1973, following a patent dispute, a judge said that Atanasoff's creation was the first digital computer.



Z3

Built by Konrad Zuse in Berlin as a secret government project, the Z3 was the first programmable computer. It was later destroyed during Allied bombing raids.



Altair 8800

Featured on the cover of *Popular Electronics*, this was the first personal computer. Microsoft founders Bill Gates and Paul Allen were smitten with the Altair and sold the manufacturer their first piece of software to run on it.



Commodore 64

The best-selling computer model ever, it was even sold in toy stores. The machine had 64 kilobytes of memory, about the size of 10 e-mails today. The machine competed with the IBM PC and the Apple II and helped launch the digital revolution.

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“No one wanted me to go to Africa: not my family, my friends, or my employers. But I thought, ‘If I don’t go now, I might never go’ ”

The Acumen Fund founder on choosing a career investing in Africa’s future over a plum offer from the COO of Chase Manhattan Bank



I was an accidental banker. To please my parents, I went for an interview with Chase Manhattan Bank in 1983. They promised to send me into their offices in more than 40 countries and essentially audit the practices. It was an extraordinary job.

I had an epiphany in Brazil. We had made a $100 million loan to an airline owner who immediately moved the money to the Cayman Islands. Yet I saw all these people in the favelas who were incredibly productive but had no access to capital. I decided to leave Chase to work with a group that wanted me to help create credit systems in Africa.

As I was preparing to leave, though, the COO offered me a once-in-a-lifetime opportunity to work directly with him. He made it clear that, in a few years, I would be able to write my ticket on Wall Street. I was torn. No one wanted me to go to Africa: not my family, my friends, or my employers. But I thought, “If I don’t go now, I might never go.” So I quit.

I ended up going to Rwanda in the late 1980s to set up a microfinance institution and a bakery. I came back to the U.S. to get an MBA and work at the Rockefeller Foundation before returning in 1996. When I got back to Rwanda, all the women from the bakery had been killed. Of the other women I’d worked with, one was killed in the genocide, another saw her family killed, and another was a perpetrator who was sentenced to life imprisonment.

The aid system was broken. The financial markets alone weren’t going to solve the problem. I wanted to invest in entrepreneurs who could see the potential of the very poor. The poor want to produce and consume and solve their own problems. In 2001, I started Acumen as a nonprofit venture capital fund. Instead of giving their money away, philanthropists could invest it in businesses. Now it’s a $50 million fund that has leveraged another $200 million of capital and created 35,000 jobs. My dream is to build this into a more powerful asset class. Everything comes at a price. I have to say no to a lot of things I love to do. But we have the potential to help build businesses that change lives. —*As told to Diane Brady*

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1. Based on published benchmark results. Results as of 9/13/10. Sources: IBM press release http://www-03.ibm.com/press/us/en/pressrelease/29315.wss and eMeter press release http://www.emeter.com/2009/emeter-demonstrates-industry%E2%80%99s-most-scalable-smart-grid-management-capability/. IBM, the IBM logo, ibm.com, Power Systems, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. Other product and service names might be trademarks of IBM or other companies. A current list of IBM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2010.

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